The Economist

George Bush, Iraq and Vietnam
PAGES 12, 25, 34 AND 41

Could AIDS explode in India?
PAGES 10 AND 21-23

China's overheating economy
PAGE 73

INTERNATIONAL BANKING
A SURVEY, AFTER PAGE 52

APRIL 17TH–23RD 2004 www.economist.com

Learning to love it

US$4.95 • C$6.95

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Advertisement

Print Edition April 17th 2004

Learning to love it
Demonised though it often is, the American retail giant is just a formidable firm in a competitive industry … More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Wal-Mart
Learning to love it

AIDS in India
Could AIDS explode in India?

Trade
Sour subsidies

Cyprus
A Greek wrecker

Iraq
Another intifada in the making

Israel and Palestine
Out of Gaza

Letters

On George Bush, poetry, China, Rwanda, South Korea, the environment

Special Report

AIDS in India
Abating, or exploding?

United States

George Bush makes his case
Something of a quagmire at home

The economy
Return from the dead

Reforming the FBI
The wrong people doing the right job

The electoral week
On the trail

Los Angeles's mayoral race
Depending on daddy

Demography
Left a bit, down a bit

The Democratic convention
A city prepares

Southern culture
Left Behind, but not forgotten

Lexington
The Vietnam Syndrome

The Americas

The Amazon
The price of success

Gridlock in Mexico
Transforming Mexico, take two

Colombia's peace process
Truth, justice and forgiveness?

Asia

India's election
The greatest show on earth

South Korea's election
Setting father against son

Japan and Iraq
Hostage diplomacy

China and America
The best of rivals

Middle East & Africa

Previous print editions
Apr 10th 2004
Apr 3rd 2004
Mar 27th 2004
Mar 20th 2004
Mar 13th 2004
More print editions and covers »

Subscribe
Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

A survey of international banking

Trust me, I'm a banker
Bothersome Basel
Just deserts?
Bigger footprints
Cracks in the pillars
Rising again?
Rooting for branches
McBank's
From Wild West to Wal-Mart
An immeasurable asset
Sources and acknowledgements
Offer to readers

Business

Linux on desktop PCs
More balls through Windows

McDonald's
Burger and fries à la française

Advertising and television
A farewell to ads?

Confectionery
Creaming it

Music and mobile phones
Ringing the changes

Vietnam's oil
Petro folly

Executive compensation
A better option

Face value
Getting Africa moving

Special Report

Wal-Mart
How big can it grow?

Finance & Economics

China's economy
The temperature is rising

Hong Kong property
Scaling The Peak

Trade
Oh, sweet reason

American pensions
Pension pork

Terrorism insurance in America
The buck stops where?

The Bundesbank
Welteke-class spat

Economics focus
A remedy for financial turbulence?

Science & Technology

Aggression and culture

Iraq
The centre holds, but only just

The mood on Iraqi streets
Bloodier and sadder

Iraq's neighbours
We told you so, but what now?

The coalition
Hanging together

Israel's pull-out from Gaza
Aren't we good, Mr President?

An election in Algeria
Freer and more peaceful

South Africa's election
Thabo Mbeki's big win

Europe

Cyprus
A derailment coming

Turkish archaeology
Biting the hand that feeds you

France's public finances
A chance or a trap?

Romania and the EU
Don't count your chickens

Russia
Playing politics from prison

Charlemagne
Dancing an Irish jig

Britain

Pensions
On the cheap

Animal-rights extremism
Playing terrorists

University fundraising
Grotty givens

Criminal justice
Charging ahead

Safety at work
The real challenges

Strikes
The state sector wants more

Premier League football
Game of one half

Articles flagged with this icon are printed only in the British edition of *The Economist*

The peacemakers

General relativity
Turn, turn, turn

Ancient jewellery
A shell game

Honeybees and the internet
The internest

Volcanoes
Winters of discontent

Books & Arts

Changing minds
Might the proper study of management be man?

Napoleon in Russia
Horse dung and all

Copyright law
Killing creativity

New fiction: Alan Hollinghurst
Pick-me-ups

Popular physics
All strung out

Hollywood and Philip K. Dick
The world according to Dick

Obituary

Leonard Reed

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Portfolio poll

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Stockmarket concentration

Emerging-Market Indicators

Overview

Road traffic deaths

Economy

Financial markets

Advertisement

Classifieds

Jobs
Governance Fellow on Security and Development (Ref 159)
This is an exciting opportunity to join one of the world's ....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
Requests Expressions of Interest for The Development of a New Lignite Mining Facility and Associated New Electric Generating and Transmission

Jobs
Marketing Associate Needed
Marketing Associate Provide analytic support to the Global Product Strategy Group Respo....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Preparation of Competition Bill for Ghana

Jobs
Regional Director Balkans
Job Profile Our Regional Director Balkans (based in Tirana), leads and mobil....

Sponsors' feature About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by = ECO PDF TEAM =
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

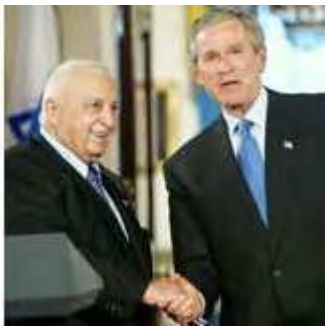
About sponsorship

Politics this week

Apr 15th 2004
From The Economist print edition

A new plan in the Middle East

AP



Israel's prime minister, Ariel Sharon, visited George Bush and received the American president's enthusiastic backing for a plan to evacuate all Jewish settlements from the Gaza Strip. Mr Bush also said that it was unrealistic in any final peace for Palestinian refugees to return to Israel proper, so they would have to find a home in the new Palestinian state. He added to Palestinian anger by saying that Israel could not be expected to make a "full and complete" return to its pre-1967 borders, given all the changes on the ground over the past decades.

See article

A shaky truce held in **Iraq**, after two weeks of fighting had left more than 90 American troops and hundreds of Iraqis dead. Sunni and Shia rebels, who said they were fighting to expel the Americans, started to negotiate through go-betweens. Meanwhile, around 40 foreign civilians were kidnapped by various groups demanding the withdrawal of foreign troops from Iraq. An Italian hostage was the first to be killed. So far, no government has acceded to the kidnappers' demands.

See article

In a rare televised press conference, **George Bush** said that the upsurge of violence in Iraq had been tough for military families and the administration, but called retreat unthinkable. He vowed to keep to the scheduled transfer of sovereignty to Iraqis on June 30th.

See article

Arab media played a taped message, purportedly from **Osama bin Laden**, offering a truce with European countries if they stopped attacking Muslims, but not with America.

South Africa's ruling party, the African National Congress, won a resounding victory in the country's third all-race elections.

See article

Joseph Kony, the messianic leader of an army of child soldiers that has devastated northern **Uganda**, broke his habitual silence to blame the Ugandan army for some massacres most observers think Mr Kony's boys carried out. He also threatened to kill Uganda's president, Yoweri Museveni.

Zanzibar's parliament agreed unanimously to outlaw homosexuality.

No warning

The White House declassified a memo given to George Bush on August 6th 2001, which touched on possible **al-Qaeda** operations in America. Condoleezza Rice, America's national security adviser, testifying to the commission investigating the attacks, said that there was no "silver bullet" that could have prevented the atrocities. Meanwhile, the commission severely criticised the FBI.

See article

Peter Coors, chairman of the eponymous brewer, entered the race for an open Senate seat in **Colorado**, and was endorsed by the Republican governor, Bill Owens. His family company cancelled a set of TV adverts in the state featuring the 57-year-old candidate.

After a stormy debate, **Iowa's** state senate rejected Governor Tom Vilsack's choice of an openly gay man to sit on the state's board of education. Mr Vilsack described the decision as “bigotry”.

Staying put

Dick Cheney, America's vice-president, confirmed during a visit to **China** that the United States did not support Taiwan's independence nor any reunification brought about by force.

American officials confirmed that Abdul Qadeer Khan, the disgraced **Pakistani** scientist who sold nuclear secrets, said he saw three nuclear devices in a secret plant in North Korea five years ago.

Pakistan created a 13-member National Security Council, including four military figures, to advise the government on security and other issues of national interest. The opposition condemned the move for reinforcing the role of the army in the country's politics.

In **Sri Lanka**, a clash between rival factions within the rebel Tamil Tigers sent thousands fleeing. The rift occurred when Colonel Karuna, a prominent rebel from the east, broke away from the Tiger leadership, which he accused of domination by northerners. His faction was defeated.

Napoleon's retreat

France's parliament gave its initial backing to a draft law that would devolve more power to the regions, in what has been called the biggest constitutional change since Napoleon forged a highly centralised state.

Akel, the leftist Greek-Cypriot party, asked for a postponment of the referendum on a UN peace plan for **Cyprus**. By stopping short of a call for a “yes” vote, the decision makes it more likely that the plan will be massively rejected.

See article

In **Ukraine**, the prime minister, Viktor Yanukovich, looked more likely to become the country's next president after aides to the current head of state, Leonid Kuchma, said that they would back the premier in elections in October.

The trial of Silvio Berlusconi, **Italy's** prime minister, on corruption charges was due to resume after a brief interlude in which he enjoyed immunity. His lawyer said he hoped it would not be necessary for the prime minister to appear in court.

Branko Crvenkovski, the Social Democratic prime minister of **Macedonia**, took a clear lead over his conservative rival in the first round of voting to find a successor for President Boris Trajkovksi, who was killed in a plane crash two months ago.

Choosing sides

Hugo Chávez, the president of **Venezuela**, sent a message of support to the insurgents in Iraq. He described the United States as an “imperialist aggressor”, which had destabilised the planet.

EPA

Despite the protests of environmentalists worldwide, the largest cull of seals in **Canada** for 50 years took place off the coast of Newfoundland and Labrador. The government claims that the exploding seal population is responsible for a decline in fish stocks, and that new rules make the hunt more humane than before.

The authorities in Rio de Janeiro requested help from **Brazil's** army to quell violence between rival drugs gangs in the city. But the federal government decided that the police had brought the situation under control. Around a dozen people were killed.

Mudslides near the Inca ruins of Machu Picchu in **Peru** killed several people and temporarily trapped hundreds of tourists.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Apr 15th 2004
From The Economist print edition

Bigger Apple

Apple Computer's share of the personal-computer market may be shrinking but it is thriving nevertheless because of sales of iPod, its wildly popular digital-music player. Second-quarter revenues jumped by 29% to $1.9 billion and profits more than tripled to $46m.

Microsoft settled yet another long-standing legal dispute. The world's biggest software firm agreed to pay $440m to InterTrust Technologies and license software from its rival to end a patent dispute over anti-piracy technology for digital files, music and film. Meanwhile, Microsoft's regular bulletin issued patches for a record 20 security flaws in its Windows operating system, with three of them described as “critical”.

Google's plans to offer free e-mail to compete with Yahoo! and Microsoft could run into difficulties. Its “Gmail” service would scan the contents of e-mails and attach relevant adverts based on the key words in return for offering far more storage space than its rivals. Privacy campaigners wailed about fresh intrusion; a California senator promised legislation to stop Google.

A worldwide recovery in technology spending pushed first quarter profits at **Intel** up by 89% compared with a year ago to $1.7 billion. But the world's biggest chipmaker said that revenues in the current quarter could fall short of analysts' expectations.

Mending a broken heart

Britain's **GlaxoSmithKline** agreed to pay *euro*453m ($540m) for two heart-disease drugs and a manufacturing plant to a French rival, **Sanofi-Sythélabo**. But the deal is dependent on the success of Sanofi's hostile bid for another French drug firm, Aventis. France's government reiterated its support for the deal, lessening the chances of a “white-knight” approach from Switzerland's Novartis.

Ryanair promised that it would continue operating from Charleroi airport in Belgium despite a European Commission ruling in February that it had received illegal subsidies to fly there. The Irish low-cost airline will present a reworked subsidy package as part of its appeal against the ruling.

Royal Dutch/Shell's internal probe into the overstatement of reserves reportedly blames Philip Watts, the former chairman, and another top executive, Walter van de Vijver, and recommends no more management changes. Both men left the company last month. Mr van de Vijver hit back by claiming that he repeatedly brought the problem to the attention of senior managers from 2001 onwards.

Good, in general

General Electric reported that profits in the first quarter were up by 8% compared with a year ago to $3.2 billion. Earnings at nine of its 11 business units grew by 10% but profits at its insurance and energy arms plunged.

DuPont revealed that a cost-cutting plan to offset higher raw-material costs would involve the loss of 3,500 jobs, some 6% of the workforce at the large American chemical company.

Domino's Pizza, the world's second-largest pizza chain, planned to deliver a slice of the company to the public. An initial public offering should raise some $300m, which will go towards repaying debts.

Full of cash

Merrill Lynch followed the lead of its big rivals by reporting large earnings. It said that first-quarter profits had nearly doubled compared with a year ago, to $1.25 billion, after burgeoning returns from investment banking. The Wall Street giant announced that it would start “investing in talent and technology” again after several years of heavy cost-cutting.

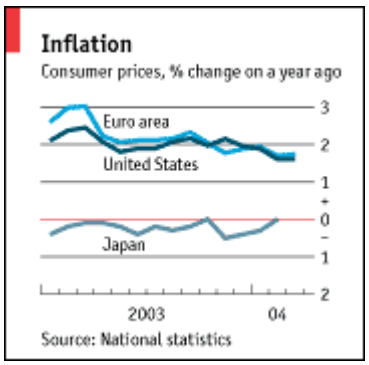
Bank of America reported that first-quarter profits rose by 11% over a year ago to $2.7 billion after improvements in consumer lending and investment banking. BofA completed its purchase of FleetBoston Financial at the end of the quarter.

Frank Quattrone, formerly a vastly well-paid star of technology banking, went on trial again in America. Mr Quattrone is charged with obstructing justice by ordering the destruction of documents related to so-called “spinning”—the allocation of shares in hot IPOs to favoured clients. A jury failed to reach agreement on the charges last October.

Rising prices

Inflation in America rose unexpectedly sharply. Consumer prices increased by 0.5% in March hitting 1.7% for the previous 12 months. Core inflation, excluding food and energy, reached 1.6%—its highest level for a year. Meanwhile, deflationary pressures eased in Japan—wholesale prices increased for the first time in nearly four years. And prices in Germany, the euro area's biggest economy, rose by 0.3% in March to 1.1% for the year.

See article



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Wal-Mart

Learning to love it

Apr 15th 2004
From The Economist print edition

Demonised though it often is, the American retail giant is just a formidable firm in a competitive industry

AP

Get article background

FOR a people who profess to love capitalism, Americans can sometimes seem mightily suspicious of the companies that deliver its benefits. No firm knows that better these days than Wal-Mart, the chain of stores which sell food and almost everything else. Founded a mere 42 years ago, Wal-Mart was first seen as a homely, family-run business. But in the intervening years it has grown and grown and grown. Along the way it has revolutionised retailing, which had seemed a dull industry. It has also become the biggest company in the world by revenues, a behemoth that strikes fear in the hearts of rivals everywhere. Just as remarkable, given its size and success, Wal-Mart looks set for yet another spurt of growth in the next few years (see article). But it has become something else as well: the target for a growing chorus of critics.

Ruthless retailing

Wal-Mart has been accused of a variety of sins. Its giant, hypermarket-style “supercentres” and “discount stores” chew up virgin land and spread suburban blight. Its ruthless policy of “Always Low Prices. Always”, it is claimed, destroys honest, hardworking mom-and-pop retailers and turns once-vibrant inner cities into urban wastelands. By purchasing $15 billion-worth of goods from China every year, Wal-Mart is destroying America's manufacturing base. The company is crushing its own suppliers, who have little choice but to do business with a firm that reaches 100m consumers every week. Perhaps worst of all, Wal-Mart's managers, claim critics, ruthlessly exploit its 1.4m employees, most of them poor and low-paid, by denying them overtime pay and frustrating their efforts to unionise.

Much of this criticism is misconceived. Despite its dazzling success, Wal-Mart did not single-handedly create out-of-town shopping, or America's growing trade imbalance with China. These are broad trends driven by a host of economic and political factors. Wal-Mart has simply proven to be one of the best firms at seizing the opportunities presented to all.

Nevertheless, has Wal-Mart now just become too big? Does its sheer size, and the political clout that comes with it, represent a threat to good government? Can the mighty retailer now shape its business environment, rather than having to adapt to it? A sober look at the facts reveals such concerns are

exaggerated. Even in America, which still accounts for the bulk of its business, the company represents only 8% of total retail sales. That is huge by the usual standards of retailing, and yet no trust-buster should allow himself to become agitated about that sort of market concentration. Many other big industries are far more concentrated.

In fact, Wal-Mart's success has varied a great deal, depending on local conditions. Some American communities, especially in the south-west and parts of the mid-west, have welcomed Wal-Mart and other so-called “big-box” retailers with open arms. Others, notably in the north-east and California, have strongly resisted Wal-Mart's advance by adopting tough planning requirements and local ordinances that restrict shop sizes. Per head of population, Oklahoma has six times as many Wal-Marts as California. As Wal-Mart begins to saturate the bits of America that like it, it is having to turn more of its attention to those which do not. Their reaction, so far, appears not to be encouraging. Earlier this month, voters in Inglewood, a suburb of Los Angeles, defeated by a hefty margin a local referendum to allow the building of a big new Wal-Mart store.

The firm's expansion abroad has also met with a mixed reception. Wal-Mart has done well in Mexico, Canada and Britain. Like all foreign retailers, however, it is struggling in Japan. Its entry into Germany has been “embarrassing”, it admits. In other words, Wal-Mart is beginning to learn about where the boundaries to the growth of its business model lie.

No guarantees

As a company, Wal-Mart has thrived by keeping everything simple, which has enabled it to operate at such a massive scale. Every supercentre store is a replica of every other one. As it begins to bump up against the boundaries that restrict its growth, however, Wal-Mart will have to introduce more complexity such as smaller shops, varied formats and different selections of products to cater to local tastes. That growing complexity will be increasingly hard to manage.

As it grows, Wal-Mart is also inevitably attracting greater scrutiny from the press, politicians, government officials and trial lawyers, and will have to demonstrate with great consistency that it strictly obeys America's (and other countries') employment laws. That is only right. But it also threatens more corporate bureaucracy, which could also slow the firm down.

Thus Wal-Mart's continued growth and success is far from guaranteed. So far, though, and despite the criticism the firm has already attracted, it has on balance been a powerful force for good, like most firms that drive up standards in any competitive market. Wal-Mart's success has been great for its customers (which tend to be the same lower-income people whom the firm's detractors want to rescue) because it has driven down prices on their behalf. It has been good for its suppliers, as its rigorous demands have forced them to improve their own efficiency and quality. It has set standards which have even inspired and challenged other industries (see our survey of retail banking). And though it has tried to keep labour costs down, it has been good for most of its employees because many are immigrants, part-timers or older people who might not otherwise have found a job.

Wal-Mart has even been good for its competitors, and so in turn their customers, because its huge success has forced rivals to improve the quality of their services in response to its challenge. Eventually, one of these competitors is likely to match, or even to surpass, Wal-Mart, just as IBM, Xerox and General Motors—once even more dominant in their industries—have been beaten in the past by companies that learned from them. Wal-Mart, of course, will strive to put that day off as long as possible but, if and when it comes, it too will be a back-handed tribute to the firm's remarkable success.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

AIDS in India

Could AIDS explode in India?

Apr 15th 2004
From The Economist print edition

Indians start voting next week to choose a new government. Its first priority should be AIDS

Reuters

Get article background

ONE subject not being discussed in India's current election campaign is AIDS. Yet, on the most conservative of estimates, 600,000 Indians already have the disease and 4.58m are infected with HIV, the virus that causes it. That means India ranks second only to South Africa in terms of its number of infections—and that with only about 0.9% of the adult population HIV-positive, compared with over 20% in South Africa. If India's rate were to rise by just a few percentage points, not only would millions more Indians be condemned to live with—or, more likely, die of—AIDS, but so would millions of their neighbours. India's population alone is much bigger than the whole of Africa's. Throw in that of Bangladesh, Nepal and Pakistan, and you have the makings of a regional pandemic affecting nearly a quarter of the world.

Fortunately, no country is condemned to follow Africa into an AIDS inferno. As has been shown by Brazil and Thailand, both of which were poised to experience an HIV calamity ten or 15 years ago, disaster can be averted. How? The policies adopted by not-so-distant Thailand probably have the greatest relevance for India. Our special report assesses how India measures up against the Thai standard and finds it is doing most of the right things, albeit slowly, late and often on too small a scale. In two particular respects, though, much more is needed: India's campaign needs more money, and it needs stronger political commitment. The two are related.

Nowhere has an AIDS epidemic been headed off without hefty expenditure. Thailand spends roughly 55 cents per person on prevention and treatment, Uganda $1.85, but India only about 17 cents. On the face of it, India's money problem is being eased. International agencies, the World Bank, bilateral donors and philanthropic foundations have all pitched in with the promise of large sums. India itself, though, has spent next to nothing. In part this reflects the country's undoubted poverty, in part the low priority that the government gives to health in general and AIDS in particular. In 2000 (the latest year for which comparative figures exist), India spent only $71 per person on health, of which four-fifths was in the private sector; indeed, on one measure government health spending was only $4 per person. India was one of only eight countries whose public-health budget took less than 1% of GDP.

This indifference to public health shows up in other statistics. India has more tuberculosis infections than any other country—over 20,000 Indians catch TB each day and almost 450,000 of them die of it each year. TB is the commonest cause of death among HIV-positive people. India is also high in the league table for sexually transmitted disease, a crucial factor in the spread of HIV. And, according to a study

paid for by the World Bank, 60% of injections in the private sector are carried out with unsafe needles; in the public sector the figure is 69%.

No wonder one UN agency thinks the number of Indian infections will rise to 12m by 2015. The government itself, in the shape of its National AIDS Control Organisation, has said that even if it achieves its own objectives 9m Indians will be infected by 2010. America's CIA predicts 20m-25m by that date.

AIDS is mostly spread by sex—in India over 80% of infections start this way—and most governments find sex an awkward subject. India's is no exception. It may be the land of the Kama Sutra, the land whose temples depict a licentiousness seldom shown in public elsewhere. But it is also a land so prudish that its film industry has only recently started to show kisses on screen. Defence is easy by comparison. India spent 3.1% of GDP on defence in 2000. It has nuclear weapons. It also has a space programme. It even offers soft loans to African countries to help them fight AIDS. But it is loth to launch an all-out programme to promote condoms. It prefers instead to preach ABC—Abstinence, Be faithful and use a Condom—a message whose crucial component tends to get lost in transmission, say those with experience of other epidemics.

In different ways, many Indians are doing their best to battle AIDS. But if they are to have a chance of success, they need help from the people at the top, and from others in every other walk of public life. The prime minister himself needs to take charge of the campaign. He needs to make all his ministers and civil servants include a message about AIDS in all their speeches and pronouncements, as the chief minister of Andhra Pradesh already does. Public figures infected with HIV—at least one prominent politician is widely believed to have died of AIDS—must stand up and encourage others to take tests. Cricketers and Bollywood stars must do their bit.

No cheap way out

AIDS is an expensive disease, expensive to prevent and expensive to treat. With a limited budget, more money for prevention means less for treatment—and why, ask some, should scarce resources go to treating homosexuals, drug addicts, prostitutes and other promiscuous people who happen to have contracted AIDS? One answer is that without the promise of treatment no one has the incentive to be tested, and without tests the disease will spread. Then it will be apparent that AIDS is also an expensive disease to neglect.

In much of the country, particularly the more prosperous parts, it already affects other groups hitherto considered low-risk, notably teenagers and monogamous wives. Were it to spread into the general population right across the country, as it has in parts of Africa, the world would have a new pandemic of hideous proportions. Fortunately, India has some advantages. It has a vast information-technology industry and its health-management companies and drug makers are capable of carrying out tests and providing cheap drugs on a huge—and as yet unexploited—scale.

America's secretary of state, Colin Powell, said last week that “HIV/AIDS is the greatest threat of mankind today, the greatest weapon of mass destruction on the earth”. India should listen. Time is not on the side of the wishful-thinkers, the makers of false economies or those who think AIDS is too unsavoury a subject for widespread public discussion. This disease demands a lead from the top, and a commitment of public money too. India cannot afford the alternative.

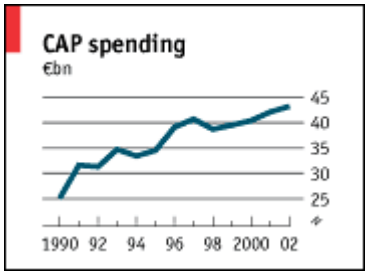
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade

Sour subsidies

Apr 15th 2004
From The Economist print edition

Without big cuts in farm subsidies, the Doha round of trade talks will drift into insignificance



LAST September in Cancún, poor countries left the bargaining table at the World Trade Organisation (WTO) talks because they felt that they were getting a raw deal. The walkout, and their refusal to compromise, was short-sighted. And yet, they had a point. After all, the European Union, America and Japan have erected massive trade barriers that impoverish farmers in poor countries. Europe spends billions of euros every year through its common agricultural policy (CAP) to subsidise its own farmers. America's farm bill means that taxpayers pay Americans to produce things such as cotton that could be grown far more cheaply in Africa. Rich-country farm subsidies and tariffs are outrageous by any rational measure. However, in the months since the Cancún meeting, America and the EU have put far too little effort into making concessions, and they are now trying to bypass the Doha round of talks with bilateral trade deals, which threatens to undermine the entire multilateral trading system.

This would be a tragedy for the poor. Rich-country farm subsidies prevent the poorest countries from selling some of the only goods, other than illegal drugs, that they are able to export, keeping millions of people miserable. Consumers in rich countries pay over the odds for food. And for what? So that a tiny number of farmers and a few large agricultural firms in rich countries can continue to benefit at the expense of the world's poor. For example, a report published this week by Oxfam, a campaigning group, describes in detail how EU subsidies for European sugar growers enrich a lucky few firms and make poor countries worse off (see article).

Such subsidies have a long and ignoble history, but today reducing them is more urgent than ever, for they threaten the chance of any further progress in multilateral trade negotiations. The debacle in Cancún has inevitably pushed back the timetable for reaching a new agreement to liberalise world trade. No one now expects any deal until well after the American presidential elections in November. Yet if not even a framework for discussing cuts in agricultural tariffs and subsidies is in place by this summer, efforts to conclude the Doha round are likely to slip well into 2006 or beyond.

Since Cancún, America has stepped up its existing efforts, in word and deed, to pursue bilateral trade deals. But while these can often lead to progress in manufacturing and services, they are less successful at reducing farm subsidies, as America's recent trade deal with Australia, which excluded sugar and barely touched beef and dairy, demonstrated. Now there are troubling signs that the EU is seeking to use bilateral trade deals to divide the concerted international opposition to its own farming subsidies by offering expanded import quotas to a handful of carefully selected farm exporters, such as Brazil and Argentina. If such bilateral deals succeed, they could entrench the CAP and similar rich-country schemes and so remove any hope of cuts in the kind of subsidies that are doing so much damage.

Pascal Lamy, Europe's trade commissioner, and his opposite number in Washington, Robert Zoellick, have often declared their determined support for the WTO. But all their high-minded expressions of respect for multilateral negotiations will ring hollow without real cuts in farm subsidies and tariffs. If rich countries are unwilling even to trim the support given to cosseted rich-world farmers and big agri-businesses, the Doha round will be seen rightly as a farce.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cyprus

A Greek wrecker

Apr 15th 2004
From The Economist print edition

The European Union should tell the Greek-Cypriots their president is wrong

EPA

Get article background

ONLY a few months ago, an historic reconciliation between Greeks and Turks—NATO "allies" who had come quite close to fighting one another on a couple of occasions in the 1990s—seemed well on track, thanks to some courageous efforts on both sides to overcome the legacy of history. Despite their deep-seated antagonism, the two nations had started to remember how much they had in common, and how much they had to gain from co-operating.

The process was exhilarating but fragile: it was disturbing to many people in the region who had a stake in keeping ancient feuds alive. But in recent days there has been good news for anyone who wants to keep the embers of conflict glowing. In an act of cynicism, the Greek-Cypriot president, Tassos Papadopoulos, has suddenly thumped the patriotic drum and urged his people to deliver a resounding "no" to a UN peace plan that he helped to negotiate (see article). If—as seems likely—the Greek-Cypriot voters follow this advice, their president will be a deeply unpopular participant at next month's Dublin summit of old and new European Union leaders.

Indeed, many will wish he were not there at all. When the Union agreed that the Greek-Cypriots could join its ranks, if necessary without a resolution of the island's conflict, this was an act of faith—intended to put pressure on Turkish-Cypriot diehards without giving *carte blanche* to the Greeks. Such faith seemed justified when the leadership of the Greeks—in both Athens and Nicosia—was in relatively moderate and responsible hands. But the behaviour of Mr Papadopoulos, elected as president last year, has vindicated the sceptics who said a truncated Cyprus had no place in the EU.

If Mr Papadopoulos deserves to be ostracised, it is not for the mere fact of saying no to the proposed peace plan. Like any historic settlement of a long and bitter conflict, the UN plan to stitch together Cyprus in a way that gives huge autonomy to each half has risks and rewards. From a Greek (or indeed a Turkish) viewpoint, it is quite possible to make a "rejectionist" case—as long as the stakes are honestly spelled out.

A dishonest case

An honest Greek rejectionist would say that the status quo, which has allowed the Greek-Cypriots to live in safety and rising prosperity since 1974, is preferable to any likely alternative; so they should forget about recovering the homes and land they lost, and settle for a permanent partition. But Mr Papadopoulos is not making an honest case for rejection. He has told his people they can cheerfully turn down the UN blueprint, with no significant cost and every expectation that a better deal will be offered in the near future. That is utter nonsense.

What the Greek-Cypriots are about to pass up may very well be their last, best chance for at least half of those displaced in 1974 to recover their homes; to bring about a massive reduction in the size of the island's Turkish garrison; and to benefit from the goodwill and assistance which a settlement would attract.

If, as now seems likely, the UN plan is accepted on April 24th by most Turkish-Cypriots and rejected by the Greek-Cypriots, one almost automatic result will be that the northern, Turkish-controlled part of Cyprus will start to reap rewards, both diplomatic and economic. Some countries may accord northern Cyprus full diplomatic recognition, and there will be no limit to the number of people from Turkey who can settle there. For all these reasons, the costs of a “no” will be very high from a Greek point of view, even though Mr Papadopoulos pretends otherwise.

Leaders of the EU (including the government of Greece) should spell out these realities—in loud, clear and simple language—to ordinary Greek-Cypriots. It may well be too late to avoid a “no” vote—but the extent of the diplomatic damage may be determined by the margin. If the “no” vote is massive, then the 30-year charade of trying to solve the Cyprus conflict by reuniting the island will be over for good.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Iraq

Another intifada in the making

Apr 15th 2004
From The Economist print edition

Having stepped to the brink, America would be wise to step back

Getty Images

Get article background

IT IS quite plain what has gone wrong. The Americans are trying to foist democracy too quickly on a country that has no experience of it. Unless, that is, they are foisting it too slowly. They paid too much attention to the Shias and neglected the Sunnis. Or maybe they took the Shias for granted. They are too quick to use force; they should have acted forcefully sooner to nip the insurgency in the bud. At any rate, the way out of this pickle is obvious: speed up/slow down the transfer of sovereignty, hand over to the United Nations (or should that be NATO?), hold elections/give up the illusion that elections can solve anything in the Arab world. And, of course, America should not have started from here.

To George Bush, who has paid so generously with his soldiers' lives and voters' taxes for the liberation and rebuilding of Iraq, the past week's cacophony of unsolicited advice and unstinting criticism must be more than exasperating. Much of the advice is contradictory and much of the criticism self-interested. But the critics cannot be accused of exaggerating the seriousness of what is now happening in Iraq.

It is true, as the spokesmen of the American-led coalition insist, that the separate uprisings of Sunnis in Fallujah west of Baghdad, and of Shias rallying in the south to the banner of a junior cleric, Muqtada al-Sadr, do not add up to a general *intifada* against the Americans. A silent majority of Iraqis may well understand that they have much more to gain from a peaceful transition to self-government that is managed by the United States and lubricated by American dollars. The trouble is that a majority that remains silent is liable to have less influence on events than a minority that takes up the gun.

The past fortnight has shown that a shocking number of Iraqis are indeed willing to take up the gun, and that most of the Iraqi policemen and soldiers recruited since the fall of Saddam Hussein prefer to lay theirs down than to fire on fellow citizens. This has left the job of pacifying Fallujah and other restive parts of Iraq to an American army that is stretched too thin and shows every sign of having reacted with excessive force. By some estimates the Americans have over the past fortnight killed 500 or so Iraqis in Fallujah. Slaughter on this scale cannot credibly be described as a policing operation designed to rid Fallujah of criminals and terrorists (see article).

An American attempt to carry out its promise to kill or capture Mr Sadr, protected by a passionate militia in the holy city of Najaf, could be bloodier still. Indeed, the danger that the Americans will unwittingly spark a general uprising by trying to put down the local ones is all too real. Even now, Iraq shows signs of slipping beyond the capacity of outsiders to help it. The country cannot be restored to prosperity if it is unsafe even for American army convoys to travel on the main roads, and while every foreign journalist, driver and aid worker is in danger of being kidnapped or worse. Many foreign governments have ordered their nationals out.

The awful consequences of failure

Mr Bush likes to assert that an American failure in Iraq is unimaginable. This, unfortunately, is not the case. What is true is that the disastrous consequences of such a failure would extend beyond Iraq itself.

Instead of offering an inspiring example to its neighbours, an Iraq that spiralled into further violence would confirm the suspicion of Arabs in general that America is an enemy of Islam. Arabs in Iraq and beyond already make the false but damaging comparison between America in Iraq and Israel in the West Bank and Gaza.

How to retrieve the situation? The best hope in Iraq is that America's tough talk against the rebels of Fallujah and Mr Sadr in Najaf is a bluff designed to incentivise its foes in both places to negotiate their way out of a showdown. Though at midweek Mr Sadr denied talking to the occupiers, mediators seem active behind the scenes. Best of all would be a signal from Grand Ayatollah Ali Sistani, the Shias' paramount spiritual leader, that the Shia mainstream disapproves of Mr Sadr's antics. But for that the coalition may need to strike some face- (and life-) saving deal with Mr Sadr. As a rule, it is a pity to let armed groups defy authority and get away with it. But Iraq is hardly a normal place right now, and Mr Sadr's is only one of many armed militias. Better, if possible, to co-opt such an enemy than risk a wider conflagration by killing him in a shrine.

Elsewhere in the Middle East, Mr Bush must not allow his Iraqi woes to continue to distract him from the need to make progress in Palestine. He made at best a quarter-step this week by embracing Ariel Sharon's plan to withdraw unilaterally from the Gaza Strip and evacuate the Jewish settlements there, as well as a few isolated ones in the West Bank. But this, as another leader argues, is not going to be enough to persuade his Arab critics that he is serious about a wider peace.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Israel and Palestine

Out of Gaza

Apr 15th 2004
From The Economist print edition

Has George Bush betrayed Palestine by his concessions to Ariel Sharon?

Reuters

A GREAT wail of indignation from the Arab world greeted George Bush's decision this week to endorse Ariel Sharon's plan to evacuate all of the Jewish settlements in the Gaza Strip. Of course a withdrawal is good, say the Palestinians, but at what price? The Israeli prime minister's transparent intention is to hold on all the more tightly afterwards to Israel's much bigger settlements in the West Bank. And instead of warning Mr Sharon that this would not be tolerated, Mr Bush tilted American policy even further in Israel's direction. To help Mr Sharon counter domestic critics of the Gaza evacuation, he showered Israel with rewards. Foremost of these were a declaration that it would be "unrealistic" in any final settlement for Israel to make a full and complete return to its pre-1967 border; and that returning refugees would have to make their homes in the new Palestine, not in Israel proper.

The mythology, and the facts

On the face of it, and certainly from a Palestinian perspective, both parts of Mr Bush's declaration look like a betrayal of basic understandings about the road to peace. The Palestinians see the "right of return" of the 700,000 or so refugees who fled or were forced out of their homes in the 1948 war when Israel was created as just that: a right that cannot be voided by anyone except the refugees themselves. They feel the same way about the pre-1967 border. Indeed, conceding Israel's right to live peacefully within these is regarded as a compromise in itself, since it means that the Palestinians end up with about 20% of historic Palestine, while the Israelis keep about 80% for themselves. And wasn't Israel's return to the pre-1967 border the central demand of Resolution 242, which was passed by the Security Council at the end of the 1967 war, and has been the cornerstone of regional diplomacy ever since?

Well, maybe (though the framers of 242 envisaged minor border changes). But as usual in the Middle East, things are more complicated than they seem. Although requiring Israel's full return to the pre-1967 border and the refugees' return to former homes in Israel proper are indeed part of the Palestinians' negotiating mythology, neither demand is taken seriously by serious peacemakers, including by the Palestinians themselves. And their moral claim depends on airbrushing out bothersome details, such as their own refusal for many years to accept 242 and drop their call for Israel's extinction.

In the talks between Israel and Yasser Arafat initiated by Bill Clinton in 2000, the Palestinian side accepted that Israel could not be expected to uproot all of the big settlement blocks it has built in occupied territory. Palestinian negotiators therefore agreed that Israel would retain some of the bigger ones, in return for compensating land swaps. Palestinian leaders also know that insisting on the return of the refugees would destroy any conceivable deal. The progeny of the 1948 refugees are now in their millions. Should a lot of them exercise a right to return, Israel would in short order lose its Jewish majority. And if there is one thing on which all Israelis are immovable and united, it is that they insist on a Jewish majority.

Mr Bush is not the first American president to say these things out loud. After the failure of his Camp David summit in 2000, Mr Clinton suggested the need for similar compromises. But was Mr Bush right to repeat them right now, when no meaningful negotiations are taking place between the two sides and he looks as though he is prejudicing what will be decided when they eventually do sit down to talk?

Up to a point he was. Without Mr Bush's help, Mr Sharon would stand little chance of withdrawing from the Gaza Strip in the teeth of furious opposition from the settler movement and the right wing of his own government. And Israel's withdrawal from Gaza is a potentially huge prize for the Palestinians, one for which they have not had to make any concession in return. That is probably the best that can be achieved for as long as the *intifada* rages and while Mr Arafat cannot or will not impose a ceasefire. In the meantime, Mr Bush insists that the “road map”, along with its vision of an independent Palestine in both the West Bank and Gaza, still stands.

In giving Mr Sharon what he asked for in return for Gaza, Mr Bush accepted one sort of reality. What he cannot now risk doing is ignoring another: that only a negotiated deal has a chance of bringing lasting peace to the two sides, and that it is still only the United States that has the ability to bring such a negotiation about. With the setbacks in Iraq, America's own standing in the Muslim world is beginning to depend on delivering much more in Palestine.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Letters

Apr 15th 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Covering George Bush

SIR – Your cover on George Bush has reaffirmed the common knowledge that Britain produces the greatest amount of disingenuous and misleading tabloid smut ("Better ways to attack Bush", April 3rd). Your demeaning depiction of our president and your mixture of condemnation and praise resembles the wishy-washy nature of his opponent. I suspect that *The Economist* has given us a glimpse of its future support of that shaky paradigm which stands for truth-spinning and confusion, and the ushering in of John Kerry. I once believed that you were a cut above your American counterparts. I regret to advise you that you have sunk into the abyss.

Joseph A. Czyzyk
Los Angeles

SIR – Your cover is an abomination. Let us compare Europe and its pacifist leaders and George Bush. When Europe reforms its ridiculous common agricultural policy one can take seriously your complaints that Mr Bush "never hears a spending plan he doesn't like" and is "weak-kneed on trade". "Hot air on WMD"? Poor intelligence and excellent misinformation put out by Iraq fooled all of us. Kindly don't be naive enough to think that France and Germany did not have ulterior motives in their opposition to the war. It is "Old Europe" that has "No cojones on Palestine and Israel" with its penchant for the Palestinian Authority, toleration of Hamas and closed eyes to terrorism as long as it is in the Middle East and against Israel. Your claim of "All hat and no plans for post-war Iraq" comes without a shred of information about our plans and changed tactics, which you will see shortly.

Shel Silverston
Englewood Cliffs, New Jersey

SIR – Your cover is priceless and my delight is not partisan. I voted for Mr Bush in 2000 and have always thought of myself as a Republican. But Mr Bush's performance has been utterly disappointing. I cannot vote for him again.

Rick Subber
Bethlehem, Pennsylvania

SIR – So you have not had enough of Mr Bush yet? This must be because you do not live here.

Dimitris Ioannou
Fairfax, Virginia

Prose, indeed

SIR – In your review of modern poetry books you say of a poet that "his line lengths are often dictated by speech movement—he breaks a line at the point where we would naturally pause for breath" ("For crying out loud", March 27th). I call that prose.

Michelle Oyen
Minneapolis

Fine China?

SIR – Your survey of China makes only a brief mention of pollution and the damaging ecological impact of China's growing economy (March 20th). In a few years this will prove a serious handicap. China's grain harvest has fallen in four of the past five years. Water tables are falling across the north of the country and as aquifers drop, irrigation wells go dry. Cities and industries get first claim on available water. Desert areas are expanding by 3,000 square miles each year and farmers are being paid to plant trees to halt this advance, thus further reducing the grain-growing area. Establishment of industrial-development zones, urban expansion and road building are all shrinking agricultural land.

John Burton
Washington, New Jersey

SIR – Despite rosy figures from the Chinese government and huge development in big coastal cities, three critical issues remain disheartening. First, widespread corruption among party officials is causing capital flight and public discontent. Between 1997 and 1999 capital flight hit $53 billion by some estimates—60% of foreign direct investment in that period. The Central Communist Party Disciplinary Committee admits that it reviewed 134,692 big corruption cases by November 2003.

Second, the widening income gap between coastal urban dwellers and inland rural farmers is alarming. Some 900m of China's 1.3 billion people are farmers who are now driven to poverty by uneven economic development. Most economists agree that China's GDP growth owes much to foreign direct investment, but foreign companies need fewer skilled workers because of advanced production technology, while large state enterprises simply cannot compete. Hence, claims that China is suffering jobless economic growth.

Third, the Communist Party has failed to carry out its policy of material growth with spiritual and moral civilisation. Most of the social ills, some argue, come from moral deterioration in a country where virtue was once revered. Some sensitive social issues such as the student democracy movement in 1989, the crackdown on Falun Gong, suppression of Christians and cyber dissidents, and revisions to the constitution were raised by delegates at a recent People's Congress conference. One positive trend arising from China's effort to integrate into the world economy, however, is that the public have become more open in expressing themselves and protecting their rights.

Erping Zhang
Association for Asian Research
New York

Rwanda's divisions

SIR – Tutsis and Hutus speak the same language, share the same society and culture and, in pre-colonial times worshipped the same God ("Rwanda, remembered", March 27th). Whatever the differences between them—race or caste perhaps—they cannot be described as different tribes. To describe them as such is to misunderstand fundamentally the relationship between them and the causes of the genocide.

Richard Dowden
Director
Royal African Society
London

SIR – You say that "outsiders" to the subject of the Rwandan genocide often assume that the genocide sprang from ancient hatreds rather than meticulous planning by an authoritarian government. Yet, on April 9th 1994 you said that "ethnic hostility in both countries [Rwanda and Burundi] stems from ancient rivalries between the tall Tutsi...and the Hutu majority". I may be an outsider but I count on you not to be.

Aaron Karnell
Alexandria, Virginia

Democratic change

SIR – I regret the implication that the impeachment of President Roh Moo-hyun was undemocratic ("A

democracy holds its breath", March 20th). Surprising and even ridiculous maybe, but two-thirds of South Korea's parliament voted for it. In fact, peaceful governmental change is probably as democratic as one can get. The Constitutional Court is there to oversee the surprising and ridiculous element.

Yoo Chang-ho
Oxford

On another planet

SIR – Why can you not review a book about protecting our environment without sneering about a "bleating environmentalist" and "environmental Cassandra" ("Green reflections", March 20th)? What planet do you live on? Not ours, I hope.

Paul Kail
Prague

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

AIDS in India

Abating, or exploding?

Apr 15th 2004 | CHENNAI
From The Economist print edition

Katz

India's HIV epidemic is at a critical stage. If it is not brought under control soon, it may grow to African proportions

Get article background

INDIA'S first cases of HIV infection occurred among prostitutes in Chennai back in 1986, when the city was still known as Madras. That was two years after HIV was first reported in Thailand, where a large proportion of men habitually used prostitutes and habitually did not use condoms. A few years later, over a quarter of young men and a tenth of pregnant women in some Thai provinces were infected. The outlook for Thailand was bleak. But by then it had launched an anti-AIDS campaign. It worked: by 2020 the country should be close to HIV-free.

The Thais adopted six policies in particular: evaluation and monitoring of the outbreak; a concentration of effort on high-risk groups; general education about HIV and AIDS, combined with a “100% condom-use programme” and a campaign to dispel the stigma associated with the disease; collaboration among as many people as possible on all fronts; international support; and political will.

India, of course, is not Thailand. For a start, Thailand is much richer (its GDP per person in 2001 was $6,400, whereas India's was $2,840). Thailand is also much smaller than India, making a national campaign much easier to conduct. Lastly, the Thais have long been relatively relaxed about sexual mores, and by 1990 had become accustomed to treating condoms as casually as soap or toothpaste. On the other hand, India has had at least ten years in which to see how AIDS can ravage an entire continent, decimate populations and set development back decades. It should know both what to do and what not to do. So how does it measure up?

Much better than a year ago, you will be told by those directing the battle from the capital, Delhi. One big departure was the convening of a parliamentary forum last July, attended by elected officials of all parties from all over India. It involved representatives high and low, from the prime minister down to the presidents of some *panchayats*, the lowest units of local government. Although at the time it seemed to produce little more than words, it gave much-needed encouragement to the efforts that had hitherto been conducted in a political vacuum or, some would say, in the face of outright official hostility.

In any event, the forum was followed in November by an announcement that the government would, from April 1st 2004, start to provide free anti-retroviral drugs to a limited number of AIDS sufferers,

welcome both in itself as a life-extender for the beneficiaries and as a signal to others that such people were not outcasts. This was strengthened by a promise to bring in anti-discrimination laws. Then came the statement—yet to be translated into action—that the government would start to spend taxpayers' money on AIDS. So far, almost everything spent on combating the disease has come from international agencies, foreign governments or charities, some of them Indian, though a few state governments have been doing their best.

Officialdom yawns and wakes up

Perhaps just as encouraging was an earlier episode in which the minister of health, Sushma Swaraj, had publicly hugged two AIDS orphans who had been refused entry to their school in a town in the southern state of Kerala. Her public display may have helped to reduce the stigma that attends almost everything about AIDS in much of India, though worse tales—of HIV-positive men losing their jobs, of women infected by their husbands and cast out by their in-laws, of AIDS sufferers stoned to death—remain common.

Officialdom was stirring elsewhere in 2003. In Andhra Pradesh, one of the six states with a prevalence rate of over 1% of the population and thus considered to be a high priority, the chief minister, Chandrababu Naidu, was insisting that all ministers should make mention of AIDS in their speeches, no matter what the topic. His state (76m population), like smaller Kerala and Delhi, had already said it would provide AIDS sufferers with drug treatment. He was also pressing for all advertisements to include a line about the disease, and for condoms to be made available at official functions and handed out free wherever alcohol was sold.

Such ideas seem old hat in places like Africa and Thailand. Perhaps that is why outsiders with experience of other epidemics have been piling in to India with a rising sense of alarm. The World Bank and UNAIDS are the two most prominent, though Britain's and America's bilateral agencies, among others, are also heavily involved. The big boost last year, though, was the announcement that the Bill and Melinda Gates Foundation would double its spending in India to $200m over five years. That has since been trumped by the decision last month to make India eligible—as the 15th of the 15 countries to be included—for help under America's Emergency Plan for AIDS Relief, a $15 billion, five-year scheme announced by George Bush in January 2003.

Neither has business been altogether a bystander. Indian Oil, the country's biggest company, has undertaken to promote AIDS awareness at 4,000 of its petrol stations on highways used by long-distance lorry drivers, a group that is particularly prone to infection and particularly likely to spread it. The Transport Corporation of India is also involved in the programme.

A message from the soaps

Star television, whose various channels are watched by 64m Indians every week, is soon to help get the AIDS message across. Each year for the next three years it will provide about $4.65m-worth of airtime for public-service advertisements about AIDS. It will also carry information and messages in drama series and other programmes, using different channels according to the target, whether young people, Hindi-speakers or Tamils.

The BBC World Service Trust has already shown how effective television and radio can be. Drawing on a successful anti-leprosy campaign in India and Nepal, it launched a similar campaign against AIDS in India in 2002, with more than 1,000 broadcasts aimed at reaching over half the population. The programmes included a reality youth show, a radio phone-in on personal health matters and, most successfully, an interactive drama featuring an HIV-positive detective, Jasoos Vijay, regularly watched by over 150m people. These programmes were accompanied by 3,500 video screenings in villages with limited access to television and radio.

Other companies, such as the Tata Group and Indian Railways, are also active. It is striking, however, that many if not all of the most committed companies are either foreign-owned—and several have experience of Africa (Standard Chartered bank, with a splendid programme, is an example)—or have been galvanised by foreign foundations.

Thus Star, partly driven by its former boss, James Murdoch, works with two American groups, the Henry J. Kaiser Family Foundation and Richard Gere's trust for India. The national television service, Doordarshan, and All India Radio have been the disseminators of the BBC World Service Trust's programmes. And Indian Oil and the Transport Corporation of India work closely with the Gates foundation.

India's highly successful drug companies—notably Cipla, Hetero Drugs, Matrix Laboratories and SRL Ranbaxy Laboratories—have been signed up by Bill Clinton's foundation for a slightly different task, namely to make anti-retroviral drugs available in Africa and the Caribbean for as little as 37 cents a day. Cipla can do this because Yusuf Hamied, the man who runs the company, thumbs his nose at the patents taken out by the rich-country companies that developed these drugs. They hate him, both for what they see as his piracy and for the embarrassment his pricing policy (or theirs) causes them. “I'm not against patents,” he says, “I'm willing to pay royalties. But I am against monopoly.”

His own government also finds Mr Hamied a bit of an embarrassment. His rip-off drugmaking is not illegal in India, but his very public pronouncements often put the Indian authorities on the spot. He has offered, for instance, to provide them with free nevirapine, an anti-retroviral that greatly reduces the chances of transmitting HIV from mother to baby during birth. That was in 2000, yet they have taken “virtually nothing”.

As long ago as 1993, after an approach by the government, Mr Hamied offered AZT, another AIDS drug, at its cost of $2 a day, a sixth of the international price, but the government had no money. Now, like Vidur Kaushik, the boss of SRL Ranbaxy, he says he could make his products even more cheaply if only the government would lift some duties and taxes on imports of reagents and equipment.

Only with a condom, please

Not far from Cipla's headquarters in Mumbai is Kamathipura, the city's red-light district. For the prostitutes there who regularly queue up at the back of a white van serving as a mobile clinic, the price of drugs is, for the moment, less important than the price of condoms. Fortunately, the People's Health Organisation, a non-governmental group set up by Ishwarprasad Gilada, hands them out free.

The women, bejewelled with studs through noses and ears, and clad in bright sarees, seem cheerful. You might wonder why. They live in brothels four or five to a room, with 120 or 150 other women. Many will have been sold to the brothel owner by a husband or father, for a sum that has to be paid off but never is. If they flee back to the village from which they came, the brothel-owner will tell the village and the prostitute—or rather commercial sex worker, or CSW, as the jargon has it—will become a pariah. Anyway, with no work in the village, what would she do there?

Yet these women are indeed lucky, relative to most of their counterparts. Dr Gilada's group has won the confidence of some of their colleagues and recruited them to become *sahelis* (the word means best girlfriend). The *sahelis* spread the word about AIDS: hence the handouts of condoms and the women's insistence that their clients wear them, hence the instant HIV tests available behind a curtain in the van, hence the swift consultation for one woman who complains of coughing blood, to be treated with capsules of antibiotics, passed to her in a torn-off piece of newspaper. Have they taken the test? Yes, says one; negative both times. The others insist a test would be pointless: they always use a condom.

Yet at a similar encounter in Chennai, the prostitutes admit that it is sometimes difficult to make their clients wear a condom—when they are criminals, for instance, or when they are drunk. Moreover, if the prostitute insists, the client may think she is infected, and bang goes her only chance of making 500 rupees ($11) that day (these women are doing well: the typical charge is more like 50 rupees).

The prostitutes are members of one of the high-risk groups that the authorities are seeking to reach—

though it should be said that most of the authorities' work is being done for them by non-governmental organisations, in this case Chennai's Community Health and Education Society. On the other side of town, where the highway to Bangalore bypasses the village of Poonamallee, members of another NGO, the AIDS Prevention and Control Project, have another such group in their sights, the country's long-distance truckers.

High-risk employment

Of the dozen truckers sitting on the floor of a transport office where they relax and play carom, a sort of cross between draughts and billiards, all know a bit about HIV and several know someone who has died of AIDS. They see their wives once every 10, 20 or 30 days; one has not seen his for over two months. As they are shown the correct way to put on a condom, one remarks that his only experience of such a product has been to use it to bind a leaking pipe in his lorry. They would like to know more about where to have an HIV test. Only one has been tested.

India, you might conclude, is doing the right things. By testing mothers in clinics and hospitals at nearly 600 “sentinel” sites across the country it has tried to assess the size of the problem. In 1992, with World Bank money, the government set up a National AIDS Control Organisation (NACO), to bypass bureaucracy and oversee the anti-AIDS campaign, and state AIDS-control societies have been active since 1998 (health is a state responsibility in India).

NACO has identified high-risk groups—male homosexuals and intravenous drug-takers, as well as prostitutes and truckers—and high-prevalence states. Last November it set up a working-group which made some useful recommendations about drugs, taxes and excise duties, machines to monitor infected people's blood (150 are needed it said, at about $30,000 each).

The good work goes on. Education campaigns are under way, NGOs are mobilised and, goodness knows, international support is forthcoming with money and advice. And yet the effort seems almost pathetically inadequate to the task.

Take, just for a start, the magnitude of the problem. No one really knows what it is: the statistics, in the words of one onlooker, are “highly suspect”. Another, Dr Gilada, reckons 8m-12m Indians are HIV-positive, and he may be in a position to know: his clinic in Mumbai—one of the few where a patient can come for advice, testing, treatment, drugs, the lot—draws patients from all over India. Officialdom has an interest in keeping the prevalence rate below 1%: above that the outbreak is considered to have spread into the general population, not just the high-risk groups.

Even the official designation of only six out of 35 states as high-prevalence can be misleading: the population of the six (Andhra Pradesh, Karnataka, Maharashtra, Manipur, Nagaland and Tamil Nadu) is 292m people, nearly 30% of the total. Three others (Goa, Gujarat and Pondicherry, with 53m people all told) have “concentrated” epidemics, with prevalence rates of 5% or more among the high-risk groups.

Admittedly, some of the statistics may overstate the problem. In general, the epidemic seems worse in the south, though it is acknowledged to be bad in parts of the north-east, close to Myanmar, where many people inject drugs with shared needles. The south is certainly where most of the effort is concentrated.

Yet it is not clear whether comfort should be drawn from this coincidence of epidemic and effort. The south generally has better social indicators than the north, better health care, better education and probably better reporting. “Worryingly,” though, “not enough is known about HIV spread in the vast populous interior of Uttar Pradesh and other northern Indian states,” remarked UNAIDS last November. The situation there may be worse than is commonly appreciated.

And everywhere, north and south, the difficulties are formidable. Too much time has been lost. The country was in denial for five years while the disease was taking hold among certain groups. Survey after survey suggests that, despite much progress, much remains to be done. For example, some 61% of women in Orissa have never heard of AIDS, reported one survey in February. Though the proportion of truckers in Tamil Nadu who reported paying for sex declined from 38% in 1996 to 17% in 2001, it rose to 21% in 2002. Only 37% reported using a condom with a casual partner. And though 90% of female prostitutes in Tamil Nadu now say they use a condom, only 45% of male homosexuals report having used one in their most recent anal-sex encounter. And so on.

The vast task ahead

Travel round India, and see and hear how, despite the efforts of so many dedicated people, the problems abound. One reason the condom campaign is not working, for instance, is that it is aimed only at high-risk groups, yet in at least six states HIV has spread to the general population, with housewives and teenagers among those infected. Anyway, how do you reach India's prostitutes when they work in so many different ways—some in brothels, some in “lodges”, some at home, some in temples, some by cinemas, some at roadside *dhabas* (eating places)?

And how do you get a powerless, battered wife to make her husband use a condom? How do you get any married couple to use one in a country where sterilisation is the commonest form of birth control? India is not condom country, and the health minister, Ms Swaraj, seems to like it that way: she has had one condom advertisement taken off the air, saying abstinence and fidelity are more important.

Health is not a high priority for Indian governments: health ministers come and go with some frequency—it is a promotion to become minister of shipping—as do the heads of the national agency, NACO (it has had six in 12 years). No wonder the government sometimes seems more concerned with pride than with prevention: the disbursal of a $100m grant from the Global Fund to Fight Aids, Tuberculosis and Malaria has been delayed because of objections about the requirement that the money can be released quarterly only if performance is satisfactory.

Efforts to reach high-risk groups are hampered by the fact that prostitution and homosexuality are both illegal, despite talk of changing the law. The stigma attached to anything to do with AIDS remains huge, especially for women, whose poverty, low status and relative powerlessness put them at a huge disadvantage. And, for all the activities of some companies, Indian business, as one of its practitioners-turned-activists puts it, is doing “close to zero”.

Against such a background, forecasts of millions more infections seem horribly plausible. Yet similar forecasts were made for Thailand and Brazil—and were proved wrong, thanks to committed intervention. It is not yet too late for India, not quite.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

George Bush makes his case

Something of a quagmire at home

Apr 15th 2004 | WASHINGTON, DC
From The Economist print edition

EPA

The president's position is not as bad as it first appears—but he surely needs to gain some political momentum soon

“THERE'S no question it's been a tough, tough series of weeks for the American people...It's been tough on this administration. But we're doing the right thing.” That was George Bush at a prime-time press conference this week vowing in the words of the oldest cliché in the book to stay the course (whatever it is).

Mr Bush did reasonably well. All the same, the aim of the press conference, only the third of his presidency and the first of any kind this year, was damage limitation. It took place at a time when he has been buffeted by an outbreak of civil disobedience in Iraq and an outbreak of questioning at the September 11th commission.

Both have been taking a toll on his public standing. His job approval, according to a Pew Research Centre study last week, fell to 43%, the lowest point of his presidency. Even if other more recent polls have shown him closer to 50%, the only incumbent with an approval around that mark at this stage of an election was Gerald Ford, who lost.

Yet public opinion on Iraq and September 11th—essentially on the periods before and after the attacks—seems likely to affect the election in very different ways. Though voters take a dim view of Mr Bush's performance before the terrorist attacks, they seem unlikely to hold that against him, if only because their opinion of the Clinton administration's record is even dimmer. For Mr Bush, the real worry is the deterioration of popular backing for the Iraq war. But this, while hurting him, is only slowly translating into support for his Democratic rival, John Kerry.

That sanguine view of the president's record before September 11th may seem odd. In a recent CBS poll, 72% of respondents thought that the administration had not paid enough attention to the terrorist threat in its first eight months and had spent too much time obsessing about things like missile defence. Just 17% agreed with the administration's claim to have taken the threat of global terrorism seriously. After Condoleezza Rice's testimony to the September 11th commission, the share rose a bit, but only to 25%.

Moreover, the national security adviser's testimony gave support to the argument that the administration had failed to appreciate the threat of unconventional terrorism partly because of the way in which it

operated. As David Broder of the *Washington Post* pointed out, she painted a picture of a decision-making process proceeding in a rigidly hierarchical, orderly fashion. Studies were delegated to the appropriate level, two-page memos were prepared; eventually a high-level meeting adopted a decision—a new strategy for confronting al-Qaeda—albeit too late. And the president went to bed at 9pm.

This was how the Bush White House always operated. It was usually regarded as an improvement on the improvisatory, free-flowing style of the Clinton White House, where the president devoured thousand-page briefing books into the early hours and woke up officials to pepper them with questions. But it may have been exactly because al-Qaeda operated in the shadows that Mr Bush's methodical “points-of-order” approach was ill suited to capture its significance.

Be that as it may, voters are not inclined to blame Mr Bush more than Mr Clinton. In a *Newsweek* poll, 18% said they thought the current president was more to blame for September 11th, 24% blamed his predecessor more, and 39% blamed both.

The refusal to point fingers—except at Osama bin Laden—is making it impossible for Democrats to use public concern about September 11th in the election campaign. When one Democratic group reportedly tested a television advertisement that accused the president of negligence, the reaction was relentlessly hostile—to the ad.

But the forbearance that marks public opinion on September 11th is replaced by increasing scepticism when it comes to Iraq. While Americans have continued to support the aims of war there, worries are growing about progress, or lack of it. In the *Newsweek* poll, a majority expressed worry that Iraq could become another Vietnam. In the CBS poll, just over a third said they thought the Iraq war was making America safer; the same share thinks Iraq is an integral part of the wider war on terror. In other words, Mr Bush has so far failed to persuade most people that, as he put it in his press conference, “the defeat of violence and terror in Iraq is vital to the defeat of violence and terror elsewhere.”

Mr Bush can expect some reinforcement for that message from Tony Blair, who was due to arrive in Washington, DC, just after *The Economist* went to press. But the White House is also nervously awaiting the publication this weekend of a new book by Bob Woodward of the *Washington Post* about the administration's path to war in Iraq. It seems likely to add more fuel to the debate about whether Mr Bush was overly obsessed with Saddam Hussein.

For the past few weeks, the erosion of public confidence in the Iraq war has not had large knock-on effects. That is, it only modestly affected Mr Bush's reputation in handling the wider war on terror. And it has not given a significant boost to Mr Kerry, who, after a brief period of high popularity after his triumphs in the Democratic primaries, has lagged behind the president. Now, both are changing.

Approval of the president for his handling of the war on terror is still higher than almost any other indicator of his standing (58% in the CBS poll, 59% in *Newsweek*). But that is significantly lower than at the start of the year. And the various surveys that match up Messrs Bush and Kerry now show the president has lost his lead. Some polls of registered voters show Mr Kerry up to seven points ahead, outside the margin of error.

Given the problems in Iraq, and the big slide in Mr Bush's popularity on other measures, it is perhaps surprising that he is holding up even this well—gloomy evidence for Democrats that worries about national security do not necessarily translate into votes for Mr Kerry. Yet a month ago, Republicans were pointing that out with a great deal more confidence.

Mr Bush's standing is now evenly poised. It has weathered weeks of bad news. Weeks more could send it spiralling downwards.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The economy

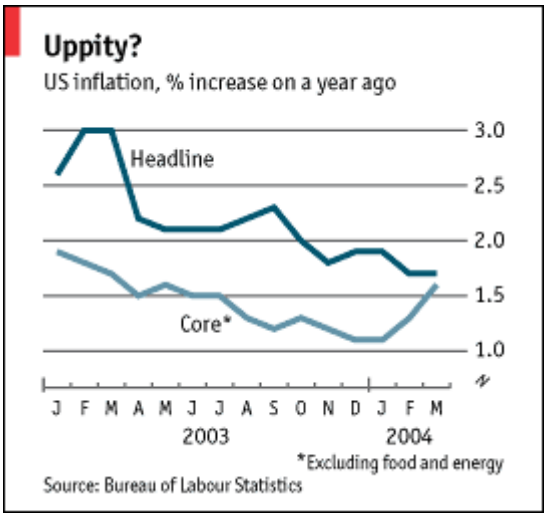
Return from the dead

Apr 15th 2004 | WASHINGTON, DC
From The Economist print edition

Just when you thought deflation was the worry

REMEMBER inflation? Remember fretting about accelerating consumer prices and higher interest rates? Those days may soon be back.

Pushed by soaring energy prices, the headline inflation rate jumped by 0.5% in March, the fourth straight monthly rise, according to figures released on April 14th. More important, "core inflation"—which excludes the volatile categories of energy and food—rose 0.4% in March, twice as fast as Wall Street analysts expected, and the fastest monthly rise for more than two years.



Core inflation is still extremely low: core consumer prices are still only 1.6% higher than a year ago. But it is rising. Core consumer prices were up only 1.2% in the year to February, but rose by an annualised 2.9% in the first three months of 2004. At the very least, it seems, America's bout of disinflation is over. Bond prices fell as Wall Street worried about higher interest rates.

Taken alone, these inflation figures are unlikely to spur America's central bankers into pushing up interest rates soon. But they will probably cause Alan Greenspan and his crew to re-evaluate the balance of risks between higher and lower inflation. At its last interest-rate-setting session the Fed reckoned the risks of lower inflation were slightly stronger.

Reading too much into one month's inflation figure would be a mistake. The spike in core consumer prices may prove to be a one-off. Much of the increase was caused by a huge jump in the costs of lodging (hotels and so forth). This category is notoriously volatile. If lodging costs had risen by their monthly average for the past year, the March rise in core inflation would have been far lower. Nonetheless, there are more reliable inflationary pressures at work, notably rising commodity prices.

Equally important, inflation is not the only economic indicator that looked strong in March. The labour market surprised everyone with a whopping 308,000 net new jobs created. And, according to numbers released on April 13th, spending is booming. Retail sales rose 1.8% in March, far faster than analysts had expected. Much of this jump came from a huge spree at building-supply stores: spending there soared by 10.6% compared with February, as Americans poured money into their houses. This spending pace, too, will be hard to keep up. But put all the March numbers together and the case for Mr Greenspan raising interest rates fairly soon looks ever stronger.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Reforming the FBI

The wrong people doing the right job

Apr 15th 2004 | WASHINGTON, DC
From The Economist print edition

Reform of the domestic intelligence services comes a step closer

SHOULD America have an MI5, bringing all its domestic-intelligence operations under one roof, as happens in Britain? In the summer of 2002, the Bush administration toyed with the idea, but rejected it, arguing that the new Department of Homeland Security and the new Terrorist Threat Integration Centre run jointly by the Central Intelligence Agency and the Federal Bureau of Investigation would be enough.

But as the commission investigating the attacks of September 11th turns to the dismal performance of the intelligence services, renewed calls for reform are coming from the top. “Now may be a time to revamp and reform our intelligence services,” George Bush said this week. Condoleezza Rice, his national security adviser, told the commission that “our work is far from complete. More structural reforms will likely be necessary.”

Cynics have wondered whether such talk was a ruse to deflect blame away from the White House. Yet a report by the September 11th commission's own staff, hitherto hardly helpful to Mr Bush, made a powerful case for reforming the intelligence services. Presented before this week's testimony by former and current FBI heads and attorneys-general, the report was, in the words of the commission's chairman, Thomas Kean, “an indictment of the FBI over a long period of time”.

Philip Zelikow, the commission's executive director, argued that the bureau, as it existed before September 11th, was unsuited to combating global terrorism. It approached counter-terrorism as it did law enforcement. Field officers had primacy, built their own cases, kept their findings largely to themselves and were rewarded for making arrests or bringing indictments. There was little by way of centrally-directed analysis and strategy. Counter-intelligence was viewed as a backwater. This made sense as a way of fighting crime, but not tracking terrorists.

Because information was not always shared even within field offices, let alone with headquarters, the FBI, as the report said, “did not have an effective mechanism for capturing or sharing its institutional knowledge.” To use the Rumsfeldian phrase, they did not know what they knew. Nor did they know what they did not know: there was no “process in place to...identify intelligence gaps”.

There was no one to connect the dots, so warnings from the Phoenix field office that suspected terrorists were taking flying lessons went unheeded. As Mr Zelikow pointed out, the bureau had not even managed to carry out an assessment of the terrorist threat on American soil.

Plenty of talk, little action

This is all familiar ground. To most outsiders—including foreign spooks—the case for some form of specialist domestic intelligence service, like Britain's MI5, where American spies, not policemen, can get on with their trade, is fairly clear. But resistance to change within the bureau, bolstered by half a century's worth of turf rows with the CIA, is strong. Predictably, the senior officials from intelligence and law-enforcement who appeared before the commission this week all blamed something other than the structure of the FBI for the mess.

Thus there were not enough resources, argued Cofer Black, the CIA's former counter-terrorism director. “We didn't have enough people to do the job and we didn't have enough money—by magnitudes.” That has changed, said John Ashcroft, the attorney-general; the Bush administration increased financing for counter-terrorism.

The problem, in his view, was “the wall”—the legal separation between intelligence analysts and criminal investigators, erected to protect intelligence sources from being exposed in court. Mr Ashcroft claimed “the wall” had blinded the government to the threat of terrorism, especially after it had been strengthened by the Justice Department in 1995, for which he blamed one of the members of the September 11th commission, Jamie Gorelick, a former deputy attorney-general.

No, that was not it, retorted Janet Reno, the attorney-general at that time: “the wall” never seriously hampered any terrorism investigation. The problem, she claimed, was the reluctance of FBI staff to respond to her demands to share information. No, it was not that either, implied Thomas Pickard, the acting FBI chief between June and September 2001. The issue, he said, was that Mr Ashcroft did not take terrorism seriously enough, and refused to hear any more about al-Qaeda after being briefed twice by Mr Pickard—accusations that Mr Ashcroft denies.

A common thread runs through this welter of buck-passing: resistance to fundamental reform. Americans would not tolerate an MI5, goes the argument. “You would in effect be establishing a secret police,” said Louis Freeh, Mr Pickard's predecessor at the bureau. “Don't create another agency,” urged Miss Reno. “Let's try to work though [the FBI].”“It would be a grave mistake”, chimed Robert Mueller, the FBI's current boss, leaving both the new agency and the old FBI “fighting the war on terrorism with one hand tied behind their backs.”

The trouble is, as Mr Zelikow argued, that attempts at incremental reform have failed. In 1998, the FBI initiated a new “strategic plan” which eventually produced an Investigative Services Division to increase the professional stature of analysts. This division was disbanded after September 11th. In 1999, the bureau set up separate divisions for counter-intelligence and counter-terrorism—and then understaffed them. Joint Terrorism Task Forces were set up to share information with other intelligence services, but their priorities reflected the concerns of FBI field offices, not any central strategy.

Another report released by the commission this week, looking at reforms within the bureau since September 11th, concluded that despite lots more money and counter-terrorism agents, the FBI “still does not know what information is in its files” and there is no national strategy for sharing that information. In other words, the law enforcement culture of the FBI remains a problem—and extra resources have not changed that.

Continuous incremental failure does not make a more radical break inevitable. If there is one thing that the FBI and CIA are good at doing, it is defending their patch: witness the complete absence of senior sackings after September 11th.

But pressure for change is growing. Frank Wolf, a Republican congressman, wants a half-way house: a separate domestic-intelligence agency with its own budget, but still within the FBI. The commission is likely to make suggestions of its own—and Mr Bush's remarks this week strengthen the case for wider reform.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The electoral week

On the trail

Apr 15th 2004
From The Economist print edition

Mistaken identity

“I don't think I look like Dick Clarke.”

Condoleezza Rice to Bob Kerrey, after the former senator repeatedly called the national security adviser “Dr Clarke”, during her testimony to the September 11th panel, April 8th

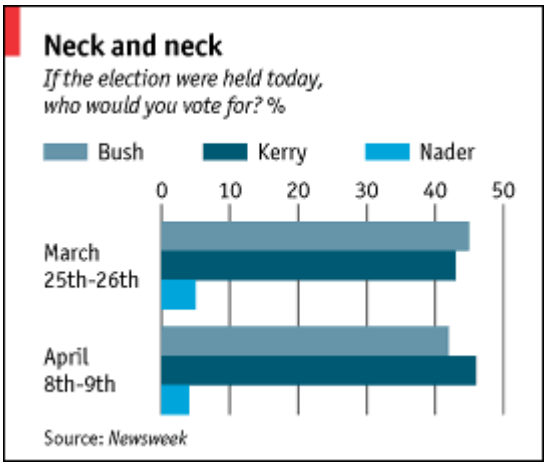
A penny for your thoughts

On their 2003 tax returns, George and Laura Bush declared an income of $822,000 and paid taxes of $227,000—a tax rate of 28% compared with 31% in 2002. John Kerry reported income of $395,000, but paid only $91,000 in taxes, a rate of 23%. The return of his wife, Teresa, who is worth $500m, was not disclosed.

I love Texas

George Bush's Easter break was the 33rd visit to his ranch of his presidency. All told, he has spent almost eight months in Crawford, Texas.

New York Times, April 12th



The political vacuum

“If it comes out any time before the election, it's not particularly good for us because he takes up a lot of oxygen.”

A “close” aide to Mr Kerry reflecting on possible publication dates for Bill Clinton's long-awaited memoirs, New York Times, April 13th

Rabble rousing

“I'll make you a deal. I'll send people to George Bush's rallies and they can bang their unemployment cheques together.”

*Mr Kerry responds to Republican protesters clapping flip-flops at a Democrat rally in New Hampshire, ABC News, The Note, April 1*3th

Web wars

If you search for “waffles” on Yahoo! or Google, your first choice is Mr Kerry's presidential website. Try the phrase “miserable failure” on Yahoo! and your first option is the official White House biography of the

president.

USA Today, April 12th

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Los Angeles's mayoral race

Depending on daddy

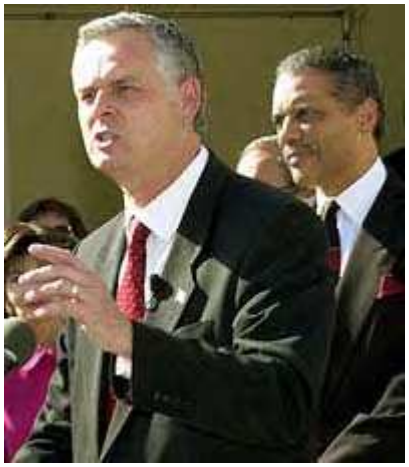
Apr 15th 2004 | LOS ANGELES
From The Economist print edition

The mayor will face a black candidate with a grudge against him

WHAT goes around comes around? Two years ago James Hahn, the mayor of Los Angeles, refused to reappoint Bernard Parks, a fellow Democrat, to a second five-year term as the city's chief of police. The reason was supposedly Mr Parks's "resistance" to reform a police department notorious for its violence and corruption. Mr Parks, now a city councillor for one of LA's poorer parts, has just announced he will be in the running next year to deny the mayor a second term in City Hall.

Mr Parks's vendetta—or at least a suspicion of it—is not the only thing that Mr Hahn, one of the city's less charismatic mayors, has to fear. Two grand juries, one local and one federal, are currently investigating allegations that companies bidding for city contracts have regularly been required to make campaign contributions for the mayor's benefit.

AP



Hahn speaks, Parks broods

The allegation is that firms had to "pay to play" if they wanted to be considered for contracts with the city's airport and harbour, or with its water and power departments. Indeed, one engineering company reportedly told federal prosecutors that it had lost an airport contract because it had refused to contribute $100,000 to Mr Hahn's campaign in 2002 against a proposition that would have let the San Fernando Valley secede from Los Angeles.

No one is directly accusing Mr Hahn of financial skulduggery. But the mayor is nonetheless having to engage in some swift damage-control. Three weeks ago he announced that three of his senior aides were leaving. Their resignations were followed last week by that of the airport commission's president, Ted Stein, who complained that he was the victim of an "array of false, defamatory and unsubstantiated allegations". And this week Mr Hahn went before the city's ethics commission to propose a "five-point plan on comprehensive ethics reform", including a ban on political contributions by actual or aspiring city contractors. That came two days after a new law, also supported by Mr Hahn, banning political fundraising by city officials.

Quite possibly such measures will be enough to redeem the lacklustre Mr Hahn, who, for all his years in city politics, still seems to be best known as the son of Kenneth Hahn, one of the city's great powerbrokers. After all, the mayor has a big war chest ($1.1m at the start of the year) and, whatever the new laws, it will be bigger still by next March's non-partisan primary.

Although Mr Parks intends to make City Hall corruption a campaign issue, many voters may well yawn, "What else is new?" And doubtless Mr Hahn will remind those same voters that as city attorney for 16 years he saw at first hand the corruption, violence and inefficiency of a police department of which Mr Parks was first the product and then the leader. He may ask them to contrast that era with the improved performance of the LAPD under William Bratton, whom Mr Hahn hired.

None of this, however, is going to guarantee re-election. One reason is that Mr Hahn's Los Angeles—a city adrift, according to Mr Parks—has plenty of problems, from congested transport to failing schools, and at a time of budgetary crisis in California there will be precious little money to put them right.

A second reason is race: Mr Hahn is white, Mr Parks is black and another declared candidate, Democratic state senator Richard Alarcón, is Latino. In the 2001 election Mr Hahn beat another Latino, Antonio Villaraigosa, by mustering the support of a small majority of San Fernando Valley whites and a large

majority of South Los Angeles blacks, who still remembered his father's work on their behalf. That feudal loyalty will be tested now there is a well-known black candidate.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Demography

Left a bit, down a bit

Apr 15th 2004
From The Economist print edition

More evidence of the move to the south and the west

THE Census Bureau has just released new details on which counties in America are growing fastest. The latest snapshot, based on tax returns, birth and death records, and health-care data, covers the period between the last full census, in April 2000, and July last year. Sixty of the 100 fastest-growing counties (in percentage terms) were in the South and 38 were in the west and mid-west. Only two were in the north-east.

Up and away

County populations, largest growth

April 2000-July 2003

Growth, %		Growth, '000	
Loudoun, VA	30.7	Los Angeles, CA	352.2
Chattahoochee, GA	29.9	Maricopa, AZ	317.1
Douglas, CO	27.1	Riverside, CA	237.3
Rockwall, TX	26.8	Clark, NV	200.8
Forsyth, GA	25.8	Harris, TX	195.5
Henry, GA	25.7	San Bernardino, CA	150.2
Flagler, FL	24.8	San Diego, CA	117.1
Newton, GA	22.8	Tarrant, TX	112.9
Paulding, GA	22.7	Orange, CA	111.5
Kendall, IL	22.0	Broward, FL	108.3

Source: Census Bureau

The county with the highest growth rate (30.7%) was the Virginian suburb of Loudoun, close to Washington, DC. Georgia had the highest number of fast growing counties (20 in the top 100), followed by Texas (12) and Florida (nine). This is not always a source of pride. For instance, there is a vibrant anti-growth movement in Loudoun, which has put some formal limits on house building.

The big numerical increases came inevitably in California, home to 13 of the fastest-growing 50 counties under that measure. The five main southern Californian counties added a total of nearly 1m people in the three-year period; but San Francisco, still reeling from the dotcom implosion, saw its population fall by 25,000 to 752,000, the largest numerical drop by any big metropolitan county west of the Mississippi (Philadelphia lost almost 40,000 people).

Southern California is blessed (or cursed) by a high birth rate and plenty of immigrants. But rising housing costs (the median house price in Los Angeles County has doubled since March 2000) are also having an effect, pushing people out into ever more distant exurbs.

Still, it is not all bad news for urbanites. Despite having 3,066 counties to choose from, almost one in four Americans live in just 30 counties that are clustered near big cities. And even in the north-east, there are signs that you can't keep a good city down. New York's population has steadily increased since the attack on the twin towers, with most of the growth in Manhattan.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Democratic convention

A city prepares

Apr 15th 2004 | BOSTON
From The Economist print edition

Police, the mayor and the governor all at odds in John Kerry's hometown

THE Democrats at large may be more united than during any recent election season, but not in Boston. Instead, a fine display of disunity between parts of the party is vexing the planning for the Democratic convention this summer.

Holding the first political convention since the terrorist attacks of September 11th 2001 was never going to be easy, even though the federal government is chipping in $25m to offset increased security costs for the Democratic event in July. Boston's police will be even more vigilant, after being blamed for failing to prevent the riot that followed the New England Patriots' triumph at the Super Bowl in February.

But security is not the only issue in the minds of the police. As it happens, the Boston Police Patrolmen's Association is currently caught in pay negotiations with the Democratic mayor, Thomas Menino. Although the police cannot strike, they are threatening to picket the convention centre during the convention.

Over 90% of the city's employees are in contract talks with the mayor. Many of them, like good Democrats, are perfectly prepared to picket the convention too. When the mayor went to Washington to raise money last month, several of the unions ran an ad in the *Washington Post*. It read, “Democratic National Committee members, heed this alarm by the people who keep our city running. We are united as never before.”

Democratic conventions seem to attract this sort of thing. In Los Angeles in 2000, convention organisers signed a pact with labour leaders guaranteeing that no strikes or pickets would be brought to the Staples Centre. That did not stop thousands of union members marching through the streets of LA during the convention. Mr Menino hopes to negotiate all the contracts before the end of July, but he may be over-optimistic. Not least, he has very little money.

And it is money that is the biggest bone of contention. Mitt Romney, the Republican governor, has not only refused to use any state taxes to finance the convention, but also will not share the revenue from increased sales taxes which the convention will bring to the state. In New York, which is hosting the Republicans in August, sales-tax money will be split between the city and the state; in Massachusetts, all sales taxes go to the state alone. Mr Romney says that creating a sharing scheme just for the Democrat shindig would be cumbersome and unfair.

He has been unhelpful in other ways, too. He recently criticised the DNC's choice of venue, saying that a new convention centre, which has yet to open, would be a safer site than the FleetCentre, a hub for trains and subways. Some residents agree, and worry that the FleetCentre will still be a mess of demolition and rebuilding by July. But local organisers point out that the opening date for the new centre was uncertain when the DNC was bidding for Boston two years ago.

Meanwhile, fundraising is going slowly. The New York host committee has nearly reached its goal of $60m; the Boston committee is $7m short of the $40m it hopes for. What with one thing and another, long-established Democratic fundraisers are feeling edgy. One Boston businessman, Joe Chung, wonders whether he will bother to write the convention committee a cheque. “How relevant are the conventions in the end?” he asks.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Southern culture

Left Behind, but not forgotten

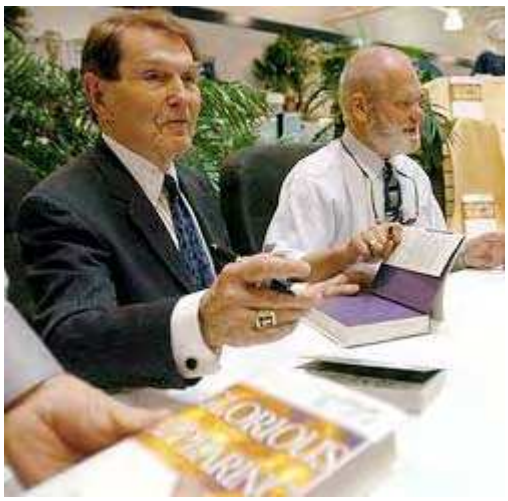
Apr 15th 2004 | BOSSIER CITY, LOUISIANA
From The Economist print edition

Who needs Mel Gibson anyway?

IT IS Sunday afternoon in Bossier City and a lengthy line of fans holding books snakes around the Wal-Mart Supercentre, past NASCAR fishing reels, tyres, plastic dishes, and facial creams. Some 200 middle-class, middle-aged white people, some still dressed in their church clothes, buzz with an excitement that rivals teens awaiting a Justin Timberlake concert.

They have come to this corner of Louisiana to see the authors of "Glorious Appearing: The End of Days"—the 12th and final part of the "Left Behind" series of books focused on the world after the Rapture (for the unGodly, the moment when God takes away the Godly and leaves the rest of us to be ruled by Satan). Tim LaHaye and Jerry Jenkins, accompanied by several black-suited handlers, duly arrive in a glitzy tour bus that has a suitably apocalyptic if somewhat spooky motif, with bolts of lightning showering down upon a silhouetted family of four.

AP



LaHaye and Jenkins burn through Bossier

Most bestselling authors strut their stuff on "Oprah" and the "Today Show", and spend as much of their time as possible in the pleasure palaces of New York and Los Angeles. By contrast, the Left Behind bus is on a tour through 12 cities in the Bible belt. More than 40% of the series' readers claim the South as home. The core buyer is a married evangelical woman, aged between 25-54, who is a college graduate and attends church weekly.

In many other countries, this would not translate into big sales. Yet the series has sold 40m copies in barely a decade; add in the spin-off books for children and that number exceeds 60m. The authors recently launched two new series of Left Behind military and political books written by up-and-coming Christian authors. Then, there are calendars, audiotapes, study guides and videos. Borrowing a trick from "Star Wars", the authors now plan to write two new series, to serve as sequels and prequels to the Left Behind books.

The success of Mel Gibson's film on the Passion should have come as no surprise to anybody who has followed the success of the Left Behind series. Mr LaHaye, a minister and the commercial mastermind, and Mr Jenkins, who does most of the writing, published the first instalment in 1995 through a small Chicago publisher—but word soon spread across the web.

Around three-quarters of the sales for the first book occurred in Christian bookstores. By the time the fifth book, "Apollyon", reached the top of the *New York Times* bestseller list, 75% of sales were in secular, mainstream outlets. Wal-Mart has done particularly well out of the books, as it has out of other conservative tomes.

Cynics may carp about their prose style; but the books cleverly blend pulp fiction with scripture—and they have struck a chord in uncertain times. People in the queue at Wal-Mart said that Mr LaHaye, a prophecy scholar, has been blessed with the voice of God whispered into his ear—just as they believe that George Bush was ordained by God to serve as president.

People still talk reverently about the moment when Air Force One landed at nearby Barksdale on September 11th 2001, for Mr Bush to address the nation after the terrorist attacks. It is rather hard to imagine John Kerry picking up many votes from Left Behind readers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Lexington

The Vietnam Syndrome

Apr 15th 2004
From The Economist print edition

It is there—but not in the way you might expect

THE most graphic measure of the Iraq war's gravity is the body count, which has taken a sharp move upwards in recent weeks. But there is also a rhetorical barometer—the “Vietnam count”—and it too has made a sharp move upwards, with Ted Kennedy dubbing Iraq “Bush's Vietnam”, *Newsweek* splashing “The Vietnam Factor” on its cover, and George Bush, in a rare press conference, dismissing the comparison as unhelpful. And this is before you factor in all the references to Vietnam, both overt and subliminal, in Lieutenant John Kerry's campaign.

There are all sorts of obvious dangers in comparing any modern venture to a long-ago war. The United States is no longer engaged in a struggle with the Soviet Union; the American army no longer resorts to the draft; and so on. The platoon of journalists who routinely liken every American military operation to Vietnam has suffered from serial embarrassments in the past decade, first in the Gulf, then in the Balkans and Afghanistan. The cherubic baritone of the quagmire choir, the *New York Times*'s R.W. Apple, has been mute this time.

Yet stopped clocks sometimes tell the right time. And, whatever the outcome in Iraq, the current struggle raises two intriguing questions about “the Vietnam Syndrome”—a condition, which for the uninitiated, might be defined as “scepticism, either prudent or debilitating according to your political taste, about both the legitimacy and the efficacy of America using military power overseas.” First, how far is Mr Bush's generally hawkish posture on the world stage driven by a deliberate attempt to eradicate the legacy of that syndrome? And, second, how far is the current mess in Iraq reviving not eradicating that syndrome?

The Vietnam war was just as formative an experience for Mr Bush's war cabinet as it was for the American left, though conservatives drew the opposite conclusion. They concluded that America needed much heavier military investment. They insisted that this investment needed to continue even after the disintegration of the Soviet Union, pointing to the threats posed by terrorism and rogue states. And they admonished their peers to cast aside the 1960s—with its “blame America first attitudes” and Age of Aquarius reservations about military power.

This enthusiasm for eradicating the Vietnam Syndrome may be most associated with the neo-conservatives (who first appeared during the Vietnam era as disgruntled Democrats furious with the anti-war movement), and with the hawks in the Pentagon and the vice-president's office. It is also true that the doves at the State Department, notably Colin Powell and his deputy, Richard Armitage, have been

reluctant to commit America to war without a clear exit strategy and a guarantee of overwhelming force. (Both men, incidentally, served heroically in Vietnam.) But, as James Mann demonstrates in his excellent anatomy of Mr Bush's war cabinet, “Rise of the Vulcans” (Viking), these are differences of means, not ends. Both “hawks” and “doves” share a common Republican dream: restoring American military prestige to its pre-Vietnam level.

Both Messrs Powell and Armitage were given their start in Washington by one of Ronald Reagan's leading hawks, Caspar Weinberger. They spent most of their careers in the Pentagon rather than in Foggy Bottom. Mr Armitage made his reputation on the sharp edge of the Reagan doctrine, trying to provide practical support for armed rebellion against the Soviet Union's client states. Mr Powell fought relentlessly for more resources for the armed forces; he has probably done more than any other soldier to embellish the American military's public standing.

In the aftermath of September 11th it looked as if the conservatives had restored America's military machine to its former glory. American soldiers trampled their way across Afghanistan (where the “graveyard of empires” folded in short order) and then Iraq (where they reached Baghdad in just three weeks). Today the picture looks decidedly murkier.

The reputation of the armed forces probably remains high. In February, 62% of Americans said that they had a great deal of confidence in their armed forces; the next most respected body, “major educational institutions”, got just 37%. Even Mr Kerry, who wanted America to get out of Vietnam, believes that America needs more troops in Iraq.

That Mekong moment

Yet even if the soldiers' standing remains high, the Vietnam Syndrome still haunts Mr Bush in two ways. First, the Iraq war is dividing the country in much the same profound way that Vietnam once did. Though most people continue to support the war (albeit with growing reservations), the left regards it as an utterly illegitimate enterprise. Second, the possibility that Iraq is indeed a quagmire grows ever larger. In 1997 Paul Wolfowitz, the most important neo-con Vulcan, justified the first Bush administration's decision not to march into Baghdad on the grounds that “conceivably, this could have led the United States into a more or less permanent occupation of a country that could not govern itself, but where the rule of a foreign occupier would be increasingly resented.” That looks a lot more sober and prescient than the more recent dreams of using Iraq to inspire a democratic revolution in the Middle East.

Perhaps the most striking historical analogy has less to do with the syndrome than with the personnel. Mr Mann argues that Mr Bush's Vulcans closely resemble the “best and brightest” who helped get JFK into Vietnam. Like their predecessors, they possess boundless optimism in American power, and boundless faith in their own ideas. They are also open to the charge that they knew more about airy-fairy theories than the situation on the ground. Donald Rumsfeld even looks a bit like Robert McNamara, the Vietnam-era defence secretary. Vietnam looks set to haunt the Vulcans for some time to come.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Amazon

The price of success

Apr 15th 2004 | SÃO PAULO
From The Economist print edition

Does Brazil have to choose between economic growth and preserving the endangered Amazon?

Get article background

DURING the 1970s and 1980s, when Brazilian governments were determined to colonise the country's last frontier, they pumped subsidies into the Amazonian interior. Today, the forces driving deforestation in Brazil are different: where once the logging and farming that eroded the forest served mainly the domestic market, it is now the demands of consumers in Europe and Asia that are driving—and accelerating—the destruction.

Last week, Brazil's government disclosed that 23,750 sq km (9,170 sq miles) of Amazon forest were felled in the year beginning August 2002, the second-worst on record. Yet this bad environmental news is linked directly to some of the best news for the economy in years: Brazil's extraordinary performance as an exporter of commodities. Does the country have to choose between the forest and foreign exchange?

The main driver of deforestation, according to a new report by the Centre for International Forestry Research (CIFOR), is a recent surge in exports of beef. A sharp devaluation of the *real* has made exports more competitive. Meanwhile, the number of Brazilian states declared free of foot-and-mouth disease has increased; the mad-cow scourge, which put some consumers off British and American steaks, has been avoided. Hence, measured by volume, since 1997 Brazil's beef exports have jumped more than five-fold. Many of the extra cows are grazing on land that was once rainforest—often illegally occupied rather than bought. Some pasture land is later used to grow soya, another commodity with a voracious international market. The ranchers move deeper into the forest.

Rates of deforestation used to track economic growth closely, says Paulo Moutinho of IPAM, an institute that studies the Amazon. Now, because agricultural exports have become so important, “these two curves diverge”, with deforestation rising even when overall growth is weak. This creates a stark dilemma. The surge in Brazil's exports has helped stave off economic disaster and reduced the country's dependence on flighty foreign capital. But the government is also committed to reducing deforestation.

João Paulo Capobianco, secretary of forests in the environment ministry, claims there is “no conflict” between the two goals. Last month, the government presented its ideas for reconciling the two imperatives in a 394m *real* ($137m) “action plan”, praised by environmentalists for making deforestation

the business of other agencies as well. The plan stresses enforcement of existing laws and “ecological-economic zoning”. It calls for making deforestation of public land a crime and for tackling the vexed issue of land titles to make it easier to control its use. The idea is to “stabilise the agricultural frontier,” says Mr Capobianco, and encourage farming on the area the size of Suriname that has been cleared and then abandoned.

There is a debate among conservationists about how effectively the government can really “stabilise the frontier”, and whether to try. “The problem is growing much more rapidly than the government's ability to deal with it,” says David Kaimowitz of CIFOR. Some experts think that the ranchers and soya farmers can't be stopped, but can be taught to take better care of the land they occupy—especially if European consumers demand clean environmental credentials.

That sort of consideration might make a compromise between greenery and growth possible. Indeed, environmentalists—many of whom once demonised ranchers and farmers—now talk about “partnership” and even “productive deforestation”. “We could oppose frontier expansion,” says Daniel Nepstad of the Woods Hole Research Centre, an American think-tank, “and in opposing it remove ourselves from the discussion.”

The paving of a highway that links Cuiabá, in the soya-growing state of Mato Grosso, to Santarém, an Amazonian port in Pará, is a test case for co-operation. Farmers and their buyers are desperate to pave a 700km-stretch of road, to cut the cost and time of getting their products to market. State governments and the local population are equally keen.

Such roads—the arteries of deforestation—are historically the Amazon's worst enemy. Yet many conservationists accept this one. The highway that carries soya to world markets can also bring in government services to the population and the enforcers of environmental law, says David Cleary of the Nature Conservancy, an NGO. It is an appealing vision of rapprochement between the economy and the environment. The future of the Amazon may depend on achieving it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Gridlock in Mexico

Transforming Mexico, take two

Apr 15th 2004 | MEXICO CITY
From The Economist print edition

Has Vicente Fox learned to deal with his recalcitrant Congress?

EVER since he took office, President Vicente Fox's relationship with Mexico's federal Congress has been traumatic. The once-mighty Mexican presidency has been humbled, and sometimes humiliated, by a legislative chamber dominated by the Institutional Revolutionary Party (PRI), which ruled the country for seven decades before Mr Fox's victory in 2000. This obduracy has stymied the president's promised "transformation" of Mexico and (say his critics) neutered his premiership. Now, though, Mr Fox is taking on Congress with new aims and fresh tactics.

All the PRI's flexing of its congressional muscles to oppose the executive might be seen as evidence of a newly self-confident pluralist democracy in action. But it has also retarded the government's attempts to make the structural changes needed to overhaul Mexico's stagnant economy. Most damagingly, the PRI has used its voting power to block Mr Fox's proposed fiscal and energy-sector reforms.

The government's latest ideas may not be as eye-catching as the once-touted revision of the country's abysmal tax system, but they are important nonetheless. Having learned the hard way, Mr Fox's team is now proposing changes that are more likely to garner cross-party support. In particular, his administration is looking to team up with the left-wing Party of the Democratic Revolution (PRD).

For example, next week, the government will announce plans to amend the constitution to incorporate new clauses on human rights. Ricardo Sepúlveda, head of the unit responsible for these reforms, says the aim is to guarantee the individual citizen's freedom from such abuses as forced disappearance. These clauses will then form a "new floor" of human rights, to which all of Mexico's individual states will have to conform.

But the most important of the new ideas is a reform of the country's inefficient and unfair criminal-justice system. The entire police force of the state of Morelos was sacked this week, after two senior officers were accused of colluding with a drugs cartel; so the government has good reason to want to create a new ministry to oversee the disreputable police service. It also wants to reform the delivery of justice, by switching to oral court hearings. A more efficient and open system may help to encourage more foreign investment.

Such initiatives will carry forward the ongoing (and overdue) modernisation of the Mexican state. Congress is already debating electoral reform, focusing on ways to cut the exorbitant amount of public money spent on political parties. Mr Fox also wants to reduce the length of election campaigns; later in the summer the government is expected to introduce another bill to give nationals living abroad—principally in the United States—the right to vote in Mexican elections.

The enemy of my enemy

Federico Döring—one of the younger legislators for Mr Fox's National Action Party (PAN)—points out that the PRD is likely to approve of much of his party's new reform agenda. Both parties, he says "are interested in human rights"—the PAN from a right-of-centre, liberal individualist angle; the PRD because of its left-wing adherence to the idea of universal human freedoms.

The two parties are also likely to co-operate on reform of Mexico's anachronistic labour laws. Both want to make the country's often corrupt and bullying unions more transparent and responsive to their members. The PRI will likely oppose these reforms, because its power traditionally rested on co-opting the support of a few union barons, who could be relied upon to deliver their members' votes. The

combination of the PAN and the PRD, however, may provide enough congressional support for Mr Fox to bypass the objections of the old enemy.

Though the current session of Congress, which formally closes at the end of this month, may spill over into May, some of the proposals will have to wait for the new session that begins in September. They will not amount to the sort of dramatic remaking of the country that Mr Fox advertised in 2000, but they do at least stand a better chance of being passed than his previous schemes. Reform of the criminal-justice system, together with other changes he has managed—such as the creation of a professional civil service and a freedom of information act—might not be such a disappointing legacy after all.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Colombia's peace process

Truth, justice and forgiveness?

Apr 15th 2004 | BOGOTÁ
From The Economist print edition

A new plan for disarming the paramilitary groups

Get article background

LAST July, President Álvaro Uribe outlined a plan for dealing with Colombia's right-wing paramilitaries. He proposed to punish any confessed killers who chose to disarm with only vague-sounding “reparations”, plus bans on seeking public office and carrying weapons. His scheme met predictable and justifiable dismay, in Colombia and abroad. So last week, Mr Uribe had another go.

He now proposes that members of the United Self-Defence Forces of Colombia (known as the AUC) who have committed “crimes against humanity” will be imprisoned for between five and ten years. A “Truth, Justice and Reparation” tribunal would sentence them, then decide whether they are eligible for reduced tariffs; if they are, the president would have the final say. In theory, the scheme would apply to Colombia's left-wing FARC guerrillas as well, though force remains the main method for disarming them. Government soldiers this week killed a family of five that they mistook for a FARC unit.

Mr Uribe's tribunal could potentially be much more forgiving than some other systems designed to ease societies out of civil conflicts. And despite American pressure, his plan makes no provision for extradition to the United States. Many of the AUC's paramilitaries moonlight as drug traffickers: Carlos Castaño, the movement's founder and ideologue, and Salvatore Mancuso, its military head, are both wanted in America on drugs-related charges. Rocío Arias, a congresswoman for an area sympathetic to the AUC, this week proposed to outlaw the extradition of reformed fighters altogether. Others doubt the wisdom of that exemption: José Miguel Vivanco, of Human Rights Watch, thinks that “the only reason these groups are today interested in demobilising is because of [the threat of] extradition.”

Mr Uribe's plan still has to make its way through Colombia's quixotic Congress. But whatever its merits or prospects, it has at least invigorated a “peace process” under which kidnappings and massacres continue, in spite of a nominal ceasefire. The AUC has now agreed to negotiate with the government en masse, rather than region by region. Previously, its leaders insisted they would never serve a day in jail; they now seem willing to spend time in so-called “concentration zones” while demobilising, which will count towards any jail sentences they ultimately receive.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

India's election

The greatest show on earth

Apr 15th 2004 | DELHI AND LUCKNOW
From The Economist print edition

AP

A contest less of policies than of opportunistic alliances

Get article background

“A FOREGONE conclusion,” says Pramod Mahajan, a strategist with India's Bharatiya Janata Party (BJP), of the resounding victory he expects in the general election that begins on April 20th. Just what a spin doctor might be expected to say, but opinion polls and analysts all agree that the BJP is likely to emerge again as the largest party in India's parliament, and that the multi-party coalition it has led since 1998, the National Democratic Alliance, is the favourite to form the government. The biggest opposition party, Congress, is expected to remain just that.

The campaign has been, by local standards, a tame affair. Such judgments are, of course, relative. In Kashmir, where separatist militants are boycotting the polls, senior politicians narrowly escaped being among the 11 people killed by a bomb at a rally on April 8th. In Jharkhand, in the east, Maoist guerrillas killed 26 policemen with a landmine explosion on the same day. In Bihar, two days later, three workers for one political party were shot dead in two separate attacks.

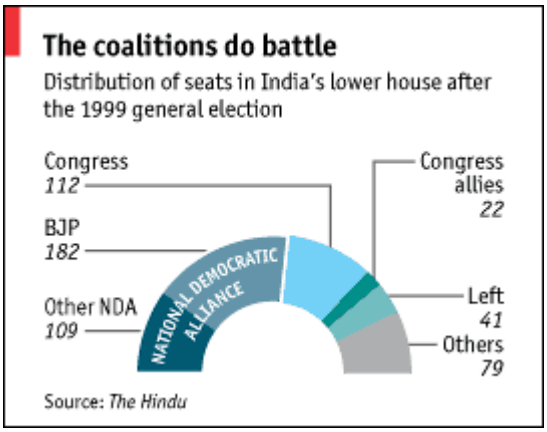
But the violence has to be seen in the context of the mind-boggling scale of an Indian election. There are six “national” parties, dozens of regional ones, and thousands of candidates. They are vying for the favours of 670m voters, of whom, judging by the past few polls, some 60% will turn out, about ten percentage points more, for example, than in the 2000 American presidential election. There are over 700,000 polling stations, with 1,075,000 electronic voting machines. To enable officials and security forces to get to where they are needed, there will be four rounds of voting, culminating on May 10th, with the results to be announced three days later.

This is the first general election in which all voting and counting will be electronic, by pushing buttons on sturdy-looking plastic boxes the size of a computer keyboard, connected by a cable to a “control unit” that resembles a large desktop calculator. They appear tamper-proof—though there are worries that biased electoral officials may hoodwink voters unfamiliar with the gadgets—and promise the remarkable feat of counting all the votes in a matter of hours.

Charged with ensuring a fair election is the fiercely independent Election Commission. The politicians

seem intent on finding new ways of breaking the rules. Late last month, for example, Vijai Sharma, the chief electoral officer of the northern state of Uttar Pradesh, banned an 11-tonne sweet. An activist in the state capital, Lucknow, wanted to offer the world's biggest Indian *laddoo* at a temple, for the good health of India's prime minister, Atal Behari Vajpayee. Since Mr Vajpayee is the local member of parliament and standing for re-election, Mr Sharma ruled that the *laddoo* had to be seen as part of his campaign. The electoral code bars the use of places of worship for campaigning.

The watchdogs were unable, however, to prevent an apparent exercise in vote-buying that led to a disaster. On April 12th over 20 women and children were killed at a rally in Lucknow, ostensibly to mark the birthday of a leader in Uttar Pradesh of Mr Vajpayee's BJP. They died in a stampede to secure sarees that were being handed out free of charge.



Technical default

This embarrassment for the BJP also highlights how hollow one of its main campaign themes—India's booming economy—rings for poor Indians, ready to risk their lives for an outfit costing about 45 rupees ($1). Perhaps for that reason, this has been a rather passionless campaign. There has been no big issue or event to galvanise it, as, say, in the 1991 election, at the height of the movement to build a temple to the Hindu god Ram on the site of a mosque at his supposed birthplace in Ayodhya.

The BJP line is that the issues this time are twofold: “feeling good”, and a “great leader”, Mr Vajpayee. The party hopes that the voters will credit it with India's present economic growth-rate of 8% a year (fuelled, however, by a lavish monsoon in 2003), and overlook four previous years of lacklustre performance. Mr Vajpayee, though he can seem rather aloof, has a stature these days that no other Indian politician can match, and is basking in the popularity of his latest effort to make peace with Pakistan.

The BJP campaign also tries to exploit prejudice against the foreign birth (in Italy) of the Congress leader, Sonia Gandhi, widow of Rajiv Gandhi, a former prime minister. But, despite its roots in a Hindu fundamentalist movement, the BJP is playing down “Hindu” issues, such as the Ayodhya temple, and is fielding more Muslim candidates. It has been restrained in office by its partners in the alliance, many of whom are reluctant to alienate India's 130m-strong Muslim minority. But in another blow for the BJP's image on April 12th, the Supreme Court ordered a retrial in a murder case arising from a pogrom against Muslims in 2002 in the state of Gujarat, where the BJP-run state government is accused of complicity in the terror and of sabotaging the judicial follow-up.

Congress is campaigning as the party of India's secular traditions, as well as of the poor, especially those in the countryside, for whom the fast-growing economy is just a distant rumour. Its economic manifesto, however, offers not so much a radical change of course as a vague hope of increasing the annual growth rate to 10%.

AFP

One Congress leader, Salman Khurshid, argues this is largely a “technical” election, less about policies than about forging competing alliances with smaller regional and caste-based parties across India's 28 states and seven “union territories”, which have less autonomy.

It is true that the next government will almost certainly be another coalition, and the count will be followed by a bout of frantic political horse-trading. The BJP hopes to improve on its showing in the last election, in 1999, when it won 182 out of 545 seats. But even Mr Mahajan says it would be “real magic” were it to get about 200 seats, so it will continue to rely on the National Democratic Alliance, albeit in a revamped form.

Congress, which ruled India for most of its first half-century of independence, and is still the only truly national party, has shed its traditional aversion to “pre-poll alliances” and has already shared seat allocations with a strong local coalition partner in four of the six biggest states, with a total of 169 seats (Andhra Pradesh, Bihar, Maharashtra and Tamil Nadu). It hopes for more than the 112 seats it won last time. But even party strategists say the maximum it can achieve is around 135.

The anvil in the north

One reason for the modesty of this ambition is the dire outlook for Congress in Uttar Pradesh, India's largest state, with 170m people and 80 out of the 545 seats in parliament. Congress holds only nine of them, and may well lose some of those. This state is where, to a large extent, India's general elections are decided. It is home not just to Ayodhya and Mr Vajpayee's constituency. It is also where Congress's Mrs Gandhi is contesting a seat, as did her late husband and her mother-in-law, another former prime minister. For the first time, Mrs Gandhi's son, Rahul, is also standing in a family stronghold.

The state is a case study in many of the ills besetting Indian politics: not just of constituencies handed down like family heirlooms; but also of venal, sometimes thuggish and often outright criminal candidates; of parties appealing not on the basis of policies but of narrow regional or caste interests; of coalitions formed not out of like-minded ideologies but out of naked power-seeking.

In Uttar Pradesh, there are no election issues, except, in Mr Khurshid's words, “the one you were born to”—the state's complex web of religion- and caste-based party loyalties. Congress has fallen through the gaps. In crude terms, the state has four blocks of voters, each accounting for 20-30% of the total: Muslims; upper-caste Hindus, such as Brahmins; dalits, the group, once known as untouchables, at the

bottom of the Hindu caste system; and “other backward castes”.

Congress used to rely on the votes of upper-caste Hindus, Muslims and dalits. Many upper-caste Hindus now vote for the BJP, which has 25 seats in the state. This time, Congress dithered over its strategy in Uttar Pradesh, torn between going it alone and seeking an anti-BJP alliance, and ending up with an underprepared campaign. It failed to woo either of two possible partners: the Samajwadi, or Socialist, party, led by Uttar Pradesh's present chief minister, Mulayam Singh Yadav, with a strong support base among other backward castes and Muslims; and the Bahujan Samaj Party (BSP) led by Mayawati, a former chief minister, and famous dalit champion.

Congress's only hope in the state—and perhaps in the country as a whole—is a “ripple effect” from the enthusiasm that has greeted Rahul Gandhi and his sister Priyanka, who has also been campaigning. Despite their youth—both are in their early 30s—and inexperience, they have drawn big crowds: their father, grandmother and great-grandfather were all prime minister. Congress contrasts their vitality with Mr Vajpayee, who is 79. Though an old man, he gives no sign of being in a hurry. But neither, for now, do the youthful Gandhis, believing that time, as well as ancestry, is on their side.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

South Korea's election

Setting father against son

Apr 15th 2004 | SEOUL
From The Economist print edition

The generational divide weighs on politics

IN ANCIENT Korea, when parents reached an advanced age and became too frail to work, their sons would carry them up to the mountains to die—part of a tradition known as *koryojang*. So when the head of the pro-government Uri Party, Chung Dong-young, was caught advising people in their 60s and 70s not to vote in this week's legislative elections, South Korea's older citizens felt they were experiencing a modern-day *koryojang*. In the storm that followed, Mr Chung was forced to resign as his party's election chief and agreed not to run in the election, which was taking place on April 15th, as *The Economist* went to press.

Beneath the country's much-vaunted adherence to Confucian precepts of filial piety and respect for elders, South Korea's compressed economic development has exacerbated the normal generational differences found anywhere in the world. South Koreans over 60 endured years of back-breaking work to push the country into the ranks of developed nations. Many feel their achievements are not recognised by younger South Koreans who are now enjoying the fruits of that success.

Vastly differing experiences between old and young have also led to ideological conflict. Older South Koreans, who had to live through the Korean civil war, are more likely to be fiercely anti-communist and pro-American. In contrast, young South Koreans form the core of anti-American demonstrations, which punctuate public life in the country. They are generally more in favour of closer ties with their neighbours in the North.

The generational differences found in wider society become particularly apparent in the political sphere, as this week's election is likely to show. The conservative Grand National Party draws much of its support from the country's older voters. Younger members of the electorate are associated with the Uri Party, whose reformist credentials play well with voters frustrated with the existing corrupt political establishment. Those in their 20s and 30s make up 47% of the 35.6m eligible voters—and people over 50 only 30%—so demographics offer a big advantage to the Uri Party, although this is partly blunted by a lower turnout among the young.

A generational shift is taking place in public life. Power is gradually being inherited by people in their 30s or early 40s who, while at university in the 1980s, spearheaded the country's democracy movement. This reformist generation is currently replacing the larger-than-life political bosses who dominated the country's politics for decades.

People in their 40s are now the largest age group in the candidate pool for the national elections. This means the average age of the new lawmakers is likely to drop dramatically from the 54.2 years of the outgoing parliament. Many of those who win this week will also be political novices.

But in spite of this power shift, South Korea's senior citizens have just demonstrated their influence by forcing the resignation of one politician who failed to show them respect. If Mr Chung's Uri Party performs poorly at the polls against the Grand National Party, South Korea's elders could prove that they remain a force to be reckoned with.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Japan and Iraq

Hostage diplomacy

Apr 15th 2004 | TOKYO
From The Economist print edition

Junichiro Koizumi's government is captive, too

EPA

Under fire too

Get article background

THE decisive test of Junichiro Koizumi's decision to send troops to Iraq was bound to come from events on the ground. But the news, when it arrived, was still a horrible shock. On April 8th, while members of Japan's Self Defence Forces (SDF) huddled safely in their compound in the southern Iraqi town of Samawa, Japan's public learned that three Japanese citizens had been kidnapped elsewhere in the country. A group calling itself the Mujahideen Brigades released disturbing video footage of their blindfolded and frightened captives, and warned that the three would suffer a ghastly death if Japan's prime minister did not withdraw the SDF within three days. Mr Koizumi refused, and a consensus rapidly began to form in Japan: if the captors followed through on their threat, Mr Koizumi's three-year-old government would collapse after the upper house elections this summer, if not sooner.

Then, just as quickly, that view gave way to confusion. On April 11th, another statement, purportedly from the kidnappers, announced that the three captives would soon be released. Among the reasons, the group cited the intervention of influential clerics in the area and the notion that the three prisoners (an aid volunteer, an anti-war researcher and a photojournalist) all represent a pacifist, anti-Koizumi and anti-American segment of Japan's public.

Hostages from several other countries were freed early this week, adding to the negotiators' bewilderment and the public's frustration. Things got worse on April 14th, when two more Japanese citizens were reported kidnapped and an Italian hostage was killed. Then, the next day, al-Jazeera reported that three hostages had been released. Whatever has happened, though, the government has been rattled.

Given Japan's pacifist constitution, the mere act of sending an SDF contingent to Iraq—even though they are non-combat troops—was a huge step. So when he took it, Mr Koizumi did his utmost to make the deployment as uneventful as possible. The government waited until early this year to send the troops and chose the relatively quiet and stable town of Samawa in southern Iraq. Troops there have spent their time building and repairing infrastructure, and have rarely been in danger.

Yet despite the safe conditions and the humanitarian nature of the mission, the deployment is still controversial. The Democrats, Japan's biggest opposition party, were against it, and public opinion was

evenly split before the kidnappings. Any significant shift in that balance could profoundly alter the course of Japan's foreign policy. For most of Mr Koizumi's term, beginning with the terrorist attacks on America in September 2001, the Japanese have been debating their security policy with a frankness that would once have been unimaginable.

There are important questions to settle. Since Japan depends so much on the world to sustain its economy and supply its resources, what more should it do to promote stability in the Middle East and elsewhere? If Japan does expand the role of the SDF, should it be to increase its independence from the United States, to help America, or to do a little of each? How much should Japan overhaul its defence strategy given regional threats such as that from North Korea? These would be tough questions for any country to answer but are especially so in Japan. Its people have lived under America's protection for more than half a century and have difficulty looking clearly on the outside world and its dangers. This week's hostage crisis, however it ends, is likely only to compound the confusion.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China and America

The best of rivals

Apr 15th 2004 | BEIJING
From The Economist print edition

Mr Cheney's visit was not too tetchy—for an election year

AP

So, do you come here often?

“OVER the course of the next several decades there is a good chance that the United States will find itself engaged in an open and intense geopolitical rivalry with the People's Republic of China.” This warning by Aaron Friedberg, an American academic, in an article four years ago coincided with the views of many in the then Bush administration-in-waiting. One of them, the hawkish Dick Cheney, has been visiting China this week for the first time since he became vice-president. Last year he appointed Mr Friedberg as an adviser. But will the trip make him any more positive about where relations between China and America are heading?

Mr Cheney was certainly at pains to be diplomatic. He said relations were “in good shape” and he praised China's co-operation in counter-terrorism efforts and in handling the crisis surrounding North Korea's nuclear programme. But the Chinese had blunt words about American support for Taiwan. Mr Cheney's Chinese counterpart, Vice-President Zeng Qinghong, called on the Americans to stop selling weapons to the island and sending “wrong signals to Taiwan independence forces”. Days before Mr Cheney's visit, the Pentagon announced plans to sell as much as $1.8 billion-worth of early-warning radar systems to the island (though Taiwan has not, in recent years, taken full advantage of American offers). China is infuriated not least by the timing of this decision: just after Taiwan's independence-leaning President Chen Shui-bian narrowly won re-election in polls that opposition parties, better liked by China, charge were unfair.

Trade disputes are becoming more prickly too. Although China has reported an unusual $8.4 billion trade deficit in the first quarter, it still has a colossal bilateral surplus with the United States ($58.6 billion last year by China's reckoning; $124 billion by America's). The approach of American elections is putting pressure on candidates to appear firm in defence of American jobs, which some interest groups claim—misleadingly—are being lost in competition with China. The AFL-CIO, an influential American labour group, last month called for trade sanctions against China because of repressive working conditions which the group says give the country an unfair advantage. The Democratic presidential candidate, John Kerry, has expressed sympathy with the appeal.

Last month America filed its first formal complaint against China in the World Trade Organisation. It accuses China of discriminating against foreign semiconductor manufacturers by giving tax concessions to chips made in China. The Americans are also angry about a Chinese regulation, due to take effect in June, that will require all wireless-networking products sold in China to use a technology made only by Chinese firms.

And then there's the value of the Chinese currency, which many American politicians say is pegged too low against the dollar, making Chinese exports artificially cheap. The dispute, however, is not as bad as rhetoric suggests. The Chinese have good reasons for not wanting to budge (see article) just now, with which some American officials privately (and many economists publicly) sympathise.

Mr Friedberg, in his November 2000 article in *Commentary* magazine, “The Struggle for Mastery in Asia”, argued that all this trade and investment could make China richer and, from America's perspective, more benign. But he dwells on the negative implications—the “muffling influence” on American strategy that close economic interaction might cause and the “increasing array of instruments” that China's growth will provide the country to engage (if it so chooses) in a “strategic competition” with America. But for all the gloom at the outset of the Bush administration, and more recent signs of friction, the relationship is far from resembling (as Mr Friedberg worried it might) the early stages of the cold war. As has become the pattern, the period building up to presidential elections is proving troubled. With the elections out of the way, the tension should drop off again. It always has—so far.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq

The centre holds, but only just

Apr 15th 2004 | BAGHDAD
From The Economist print edition

The recent violence has shed light on who really speaks for Iraqis

Get article background

FOR Baghdadis, April 2004 has had eerie echoes of April 2003. The streets emptied; children stayed away from school. In scrappy street battles around the country, more than 90 coalition troops have died this month, making it the deadliest for the Americans since the fall of Saddam Hussein. And just as Saddam's army melted away from the battlefields, so Iraq's new security forces fled at the first gunshot rather than fight for the Americans against their rebellious compatriots.

Had the battles raged for more than a week, the revolt might have spun out of control. America stirred up trouble when it attacked the Sunni Muslim stronghold of Fallujah, threatening to turn not only Fallujans into rebels, but also their tribal affiliates as far north as Mosul. At the same time, the American assault on a militia led by Muqtada al-Sadr, a Shia firebrand who has urged Iraqis to rise up against the occupation, risked goading southern Shias. While the rebels gathered support, America's coalition in Iraq started to look wobbly. Ukrainian soldiers fled their positions. The American-appointed Governing Council pondered resigning en masse. It was, admitted the coalition's military leaders, their worst week since entering Iraq.

But somehow, the country has pulled back from the brink. The Governing Council decided not to quit after all, and showed rare pluck in persuading the belligerents to stop shooting. The Iraqi Islamic Party—a proxy for one of the oldest Sunni movements, the Muslim Brotherhood—shuttled between tribal patriarchs and American officials. Ibrahim Jaffari, the leader of a Shia party, Dawa, relayed messages between Paul Bremer, America's proconsul in Iraq, and the Iraqi ayatollah in Iran from whom Mr Sadr draws inspiration.

A partial ceasefire is giving all sides a chance to negotiate, though some rebels in Fallujah continue to shoot at the American tanks that surround them. Coalition forces have also encircled the Shia holy town of Najaf, and threaten to attack if Mr Sadr's militia does not disband.

Fortunately, there are at least clear lines of communication. Fallujah's tribal leaders trooped to the coalition headquarters for talks. Mr Sadr has appointed a negotiator. And all are moderating their demands. American generals who vowed to get Mr Sadr dead or alive have stepped aside for politicians who say he should merely be arrested. Instead of demanding the surrender of all those who took part in

the hanging, drawing and mutilating of four American military contractors at the end of last month, the generals are calling for the handover of the non-Iraqi *jihadi*s they say are holed up in Najaf. The rebels, meanwhile, have dropped their demand for a full withdrawal of American troops from Iraq, and now say they just want them out of their own cities.

The conflict may have abated, but its causes have not. Ten weeks before the planned handover of power to Iraqis on June 30th, Mr Bremer has yet to spell out what kind of government he will install. He has recently tended to ignore the Governing Council, for example when appointing a new interior minister. Sensing a political vacuum, various factions, including those led by members of the Council, are building up their own militias—sometimes in the guise of private security firms—and cementing their grip on the parts of the country they seized after the invasion last year. Sufi brotherhoods, who command the loyalty of millions of Sunnis, are creating a military wing. The only Iraqi brigade to fight on America's side this month was one composed of Kurdish *peshmergas* and the Free Iraq Forces of Ahmed Chalabi, a member of the Governing Council.

A resistible force

The national police and army, meanwhile, are looking feeble. The few who have returned to the towns they fled have shed their uniforms, after receiving leaflets warning them not to serve the occupation. The militants in both Fallujah and Najaf insist that only locally-recruited police should be allowed to patrol their streets. Locals will most likely obey local politicians, rather than the Americans, so these two hotspots will doubtless remain hot. After retaking Kut, another town briefly controlled by Mr Sadr's militia, the Americans imposed a curfew that pointedly included the town's police.

The coalition's supply lines remain dangerously exposed. The charred remains of fuel, food and military convoys litter the highways into Baghdad. Truck drivers are either too scared to work for the Americans, or charge exorbitant rates. The kidnapping of over 40 foreigners has shattered investor confidence and grounded expatriate managers, just after $5 billion in reconstruction contracts were awarded. The violence interrupts the restoration of basic services to Iraqis, which begets discontent, which may beget more violence.

Is there a way out? Optimists argue that the bloodshed must have concentrated minds. It has given America a better idea of which Iraqis wield real influence. Most members of the Governing Council bleated from the sidelines during the fighting, but a few won popular credibility by acting as mediators or organising relief programmes. The groups that showed the most gumption include Mr Jaffari's Dawa party and Mohsen Abdel Hamid's Iraqi Islamic Party, which is backed by some Sunni preachers. The ayatollahs in Najaf, led by Ali Sistani, have sent their sons to soothe Mr Sadr, only to hear Mr Sadr's aides brand them American spies.

This month's unrest has also spurred America to talk to Iraqis with local constituencies, rather than the exiles it had previously appointed to govern. Many of the local leaders are anti-American and religious chauvinists. But Mr Bremer will have to find ways to co-opt them. His advisers say he is working on a final draft of 125 names for a National Assembly, which will be summoned next week to begin choosing Iraq's post-occupation government. He would be wise to ensure that hitherto marginalised groups, such as the Sunnis of Fallujah and the impoverished Shias who support Mr Sadr, are represented.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The mood on Iraqi streets

Bloodier and sadder

Apr 15th 2004 | BAGHDAD
From The Economist print edition

Most Iraqis want peace, but it takes only a few to make war

Get article background

A FORLORN placard at the entrance to the coalition's headquarters in Baghdad still asks passing American soldiers: “What have you done today to help Iraqis?” Such friendly language is getting rarer. Ricardo Sanchez, the top American general in Iraq, used the word “enemies” nine times at a press conference this week. Iraqis—who, according to American generals, have endured ten times as many casualties as coalition troops—often use similar terms for Americans.

EPA

When we're gone, running Iraq will be up to you guys

The pictures of Fallujah's dead and injured, beamed into homes via satellite, have turned many undecided Iraqis against America's mission. Few now care to recall that they have satellite dishes only thanks to America. Banners hang from Baghdad's main Sunni mosque, denouncing America's “Zionist” plans. Its loudspeakers bellow out sermons damning the Americans for slaughtering Iraqi women and children and humiliating their menfolk. “If we said anything different, the people would kill us,” explains its imam.

Last week, the same mosque urged Iraqis to rise up and attack American troops, in solidarity with their kin in Fallujah. The next day, American soldiers raided the mosque and, say the preachers, destroyed food parcels destined for Fallujah's besieged. Marines claim to have found ammunition among the care packages.

America's sometime partners on the Governing Council argue that there were better ways of containing the violence than storming mosques. If the Shia could show forbearance after 150 were killed on their holiest day, Ashoura, could America not contain its revenge after four of its nationals were murdered? “It's embarrassing for Mr Bush, when he came to rebuild and invest in Iraq,” sympathises an Iraqi exile.

Others are gloating. “Thanks to America, we're healing the Shia-Sunni divide,” says the Sunni imam, rejoicing at the way clerics of both denominations have united against the Americans. They seem to be sharing tactics, too. Most of the foreigners who have recently been abducted were seized in the Sunni zone along the Fallujah road. But when Italian troops stormed the offices of Muqtada al-Sadr, the most

prominent Shia advocate of rebellion, in Nasiriya, farther south, they found a British contractor cowering inside.

Different rebels have different aims. The Sunni gunmen of Fallujah are struggling to regain the political supremacy they enjoyed under Saddam Hussein, with all its perks. Mr Sadr's followers, by contrast, are shanty-town Shias who have never enjoyed any kind of power. These were the people who swept through the nicer parts of Baghdad after Saddam's fall, looting in the name of the Hawza (the Shia Vatican), to the horror of mainstream ayatollahs and middle-class Iraqis.

One year on, they have spilled once more out of the slums. Besides robbing banks, Mr Sadr's acolytes took over the Red Crescent's headquarters in Baghdad and threatened to kill aid workers who disobeyed them. In one case, they made good this threat. Many Iraqi policemen, sharing Mr Sadr's followers' love of loot and hatred of foreigners, took their side. Some senior officers ordered underlings to hand over their weapons to the rebels.

But many Iraqis distrust Mr Sadr. Can Muqtada cut our foreign debt, asks one, crestfallen to see his fellow Iraqis embracing another despot. Dawa, the oldest Shia party in Iraq, discourages its supporters from joining Mr Sadr's rallies. Outside the cities of Baghdad and Kufa, Mr Sadr's support appears marginal.

But even a small minority can cause big trouble. The Green Zone where the coalition has its headquarters in Baghdad is now dubbed the “Red Zone”. Four rockets landed there with a boom as your correspondent was writing this paragraph. Those who live outside its concrete walls must brave car-bombs and kidnappers, who circulate flyers urging Baghdadis to call a number to let them know where foreigners live. The planes out of Iraq are filling as fast as they dare land.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq's neighbours

We told you so, but what now?

Apr 15th 2004 | CAIRO AND TEHRAN
From The Economist print edition

America's embarrassed allies, and agitated foes

Get article background

AMR MOUSSA, the Arab League's secretary-general, famously gave warning that an American invasion of Iraq would “open the gates of hell”. Ali Akbar Hashemi Rafsanjani, a former president of Iran, predicted a quagmire. And on the streets of pre-war Baghdad, a Palestinian resident assured your correspondent that ordinary Iraqis would sit tight for the invasion, give the Americans six months' grace, and then start shooting them.

Understandably, therefore, the region is chorusing “we told you so”. But beyond the grim satisfaction of feeling themselves proved right, Iraq's neighbours differ greatly in appraising the mess, though they are all, by and large, worried. None likes such untidiness next door.

AP

Taking a nuanced view of events in Iraq

The tarnishing of American prestige reflects directly and badly on the governments of its allies: Turkey, Jordan, Egypt and Saudi Arabia. What is worse, from their point of view, is that by recharging the symbolism of popular resistance to alien rule, Iraq's creeping *intifada* risks empowering the Islamist extremists who, to varying degrees, threaten them all.

Israel, which was alone in backing the war wholeheartedly, has other reasons to be anxious. An American failure in Iraq could create a vacuum that Israeli analysts assume would be filled by forces hostile to the Jewish state. Zeev Schiff, a seasoned Israeli military correspondent, gives warning of eventual Iranian intervention, and with it the unspoken spectre of possible nuclear weapons close to Israel's own.

What Israel might do in such circumstances becomes, in turn, a worry for Iran and Syria too, a worry to be added to the existing fear they share with Turkey that a collapse in Iraq could lead to the creation of a breakaway Kurdish state that would stir up their own Kurdish minorities. Yet there are some within the Syrian and Iranian establishments for whom the gain of hurting America outweighs other factors. The shaky Baathist regime in Damascus is wise enough to keep silent, but must surely feel that America's woes in Iraq are one reason why the Bush administration has refrained from slapping long-threatened sanctions on Syria.

In a sermon last week, Mr Rafsanjani, who remains powerful among Iran's conservatives, praised Muqtada al-Sadr's Mahdi Army, saying that it was made up of “enthusiastic, heroic young people”. But this does not mean that there is co-operation, let alone trust, between the Iranians and Mr Sadr. Iran sees him as a probable loser, and would rather have Grand Ayatollah Ali Sistani on its side—though this could change if Mr Sadr were to spurt forward in popularity and power.

Iranians want influence in Iraq, whichever Shia leader succeeds, but are not thinking of installing a carbon copy of the Islamic Republic. The Iraqis are cautious too. Mr Sadr's father, the late Ayatollah Muhammad Sadiq, admired Iran's theocracy. But Mr Sistani, while favouring a strong guiding role for the clergy, follows a quietist brand of Islam, shared by many liberal Iranian clerics, that counsels the

separation of religion and politics.

On the Arab street, emotions have risen to a pitch not seen since the war itself. Media coverage of the siege of Fallujah includes newspaper photos of stray dogs chewing on unburied corpses, and dramatic televised appeals from inside the stricken city. For a time after the deflatingly swift capture of Baghdad, public opinion on Iraq had been confused. But the mass killings in Fallujah, plus the stoking of pan-sectarian anger, have once again produced a seemingly clear narrative.

Press commentary, from the Gulf to Morocco, has noted, with striking uniformity, the parallels between the Fallujah carnage and Israel's efforts to crush Palestinian resistance. Mosque preachers across Saudi Arabia, ignoring government instructions, add to each of the five daily prayers a special supplication for God's aid to fellow Muslims in defeating the enemy. And a group of 67 senior independent clerics from some 20 Muslim countries has asked the international community to halt the “brutal genocide” that shows America's “blind hatred for Muslims”.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The coalition

Hanging together

Apr 15th 2004
From The Economist print edition

Hope delayed

Get article background

WISHING to steady the nerves of the more than 30 other governments with troops on the ground, Britain's prime minister, Tony Blair, was due to meet President George Bush on April 16th for what seemed bound to be a summit-of-the-resolute. And while Mr Bush this week was promising the American public that he would stay the course in Iraq, his vice-president, Dick Cheney, who happened to be in Asia, was working to stiffen the resolve of the Japanese and South Korean governments; both have some 500 troops in Iraq, and still have plans to deploy more. But the broader diplomatic outlook is now more complicated than ever.

After some ostentatiously gruesome murders, foreign civilians in Iraq are frightened. A number of governments have advised their nationals to leave the country, a message that, if heeded by many for long, will have a greater immediate impact on reconstruction efforts than on security. More than 40 foreigners have been taken hostage in the past two weeks.

But so far, the coalition is hanging together. Japan's prime minister has vowed not give in to threats (see article). South Korea's foreign minister likewise insisted this week that the dispatch of over 3,000 more troops would go ahead; plans to send them to Kirkuk had earlier been scrapped, and quieter spots are being looked at. The Philippines said it would consider whether or not to withdraw its tiny contingent of 50 soldiers, police and medical workers in the light of “the security situation in the days to come”, but this was seen as an effort to fend off criticism ahead of an election next month.

The greater damage may be to the diplomatic hopes riding on an orderly transfer of sovereignty on June 30th from the occupiers to a more broadly-based interim Iraqi government. A new UN Security Council resolution blessing the process leading to elections early next year would, it had been hoped, encourage more governments to join both the stabilisation and reconstruction efforts.

No such resolution has yet been drafted, and none might in the end satisfy Spain's incoming Socialist government. Even before the recent violence, it had vowed to pull out its 1,300 troops unless the UN was put “in control” in Iraq. That is not a task that the UN has ever wanted. And this week, Kofi Annan, its secretary-general, mindful of the bombing of the organisation's Baghdad headquarters last year that forced its virtual withdrawal from the country, suggested that the latest violence may again constrain the help the UN could offer in Iraq.

So far no one is suggesting that the June 30th date be postponed. France and Germany, both opponents of the war, had indicated that they would offer greater support, though still no troops, if asked by a sovereign Iraqi government. And while NATO's secretary-general insists that it must first get Afghanistan right, the alliance's Istanbul summit in June is expected to explore ways it could be of help to a new Iraqi government (beyond already supporting the Polish command of a multinational division there). But unless order can be restored, Iraq may not be able to benefit much from its new-found sovereignty.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Israel's pull-out from Gaza

Aren't we good, Mr President?

Apr 15th 2004 | JERUSALEM
From The Economist print edition

Ariel Sharon gets a lot of what he wants from George Bush

Get article background

WHEN last December Ariel Sharon announced his plan for Israel's unilateral “disengagement” from the Gaza Strip, many chose to be sceptical. Some suggested that it was merely a blocking tactic, designed to pre-empt any international move to solve the lethal Israeli-Palestinian conflict. Others argued that promising to give up Gaza, with all its troubles, was little more than diverting attention from the more important West Bank.

But Israel's prime minister stuck to his guns. His military planners have quietly let it be known that there are tentative plans to start uprooting the two dozen or so Israeli settlements (housing the 7,000 settlers who make life even more crowded for the 1.2m Palestinians) much earlier than the original plans for next year. And this week Mr Sharon was in Washington to get George Bush's blessing for his determination to bring Israel's 36-year occupation of Gaza to an end.

Solid American support for the disengagement plan is thought crucial to Mr Sharon's success in getting it agreed to in a referendum of his Likud party's 200,000 members. He has said he will go with the members' decision, but hardliners oppose the plan, and the numbers are believed to be fairly evenly divided. The referendum will now take place on May 2nd—postponed from April 29th because that clashed with the finals of the European club basketball championships in Tel Aviv.

In particular, Mr Sharon was anxious that the American administration accept Israel's right to “self-defence”—the army's right to return—if Palestinian hostilities continue out of Gaza. Looking further ahead, towards a possible resumption of peace negotiations at some future date, Mr Sharon wanted as much American agreement as possible to Israel's insistence that the Palestinian refugees have no right of return, and that the large settlement blocks in the West Bank—Maaleh Adumim, Ariel, Gush Etzion and around Jerusalem—become a permanent part of Israel.

In the event, the prime minister got what he wanted. Mr Bush insisted that the security barrier Israel is building in the West Bank should be temporary, and that its route should take into account the impact on the Palestinian population. But he also called Mr Sharon's planned withdrawal from Gaza and a few West Bank settlements “historic and courageous”. He accepted that in any peace settlement the needs of the Palestinian refugees would have to be met within the new Palestine rather than Israel proper. And while promising not to jeopardise the outcome of any future drawing of borders between the two sides, he said that in light of new realities on the ground, “including already existing major Israeli population centres”, it was “unrealistic” to expect the outcome of such talks to be “a full and complete return to the armistice lines of 1949.”

Reuters

The Palestinian Authority expressed outrage. A furious Yasser Arafat reiterated from Ramallah on the West Bank the Palestinians' right to return to their “homeland” inside Israel. Ahmed Qurei, the PA's prime minister, said that Mr Bush was the first American president to have legitimised Israel's settlements in the occupied territories, and that this was unacceptable. Some reports said he was pondering resignation. Kofi Annan, the UN's secretary-general, also voiced reservations, expressing his preference for a negotiated agreement based on UN resolutions, rather than unilateral steps. But negotiations between Israel and the PA have so far been stuck at the first fence, by the Israelis'

refusal to talk to Mr Arafat, whom they accuse of conniving in terrorism, and the PA's inability, or unwillingness, to impose the ceasefire called for in the international “road map”.

Mr Sharon's visit to Mr Bush was sandwiched between visits by Egypt's Hosni Mubarak and Jordan's King Abdullah. With Arab allies in mind, Mr Bush is anxious to demonstrate that Israel's unilateral withdrawal from Gaza is not inconsistent with the larger plans of the road map. The Arab world has doubts about this. But, enforcing the belief that the Gaza pull-out will not remain the end of a beginning, Yoel Marcus, a leading Israeli columnist, wrote: “To paraphrase Churchill, [Sharon's plan] may be deemed the beginning of the end of the occupation.”

Young Israelis learn from their neighbours

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

An election in Algeria

Freer and more peaceful

Apr 15th 2004 | ALGIERS
From The Economist print edition

An Arab state slouches towards democracy

Get article background

NOTHING is quite what it seems in Algeria. A half hour's drive south of the capital, the road to the provincial town of Medea enters a deep gorge. The watchtowers, checkpoints and armoured-car patrols that punctuate every winding mile suggest that security, in this huge and rugged country whose waning civil war has cost perhaps 100,000 lives, remains tenuous.

But the sight of families picnicking by roadside streams, and happily feeding the local Barbary apes, hints that things are not so bad after all. Similarly, the election that has just resoundingly won Algeria's president, Abdelaziz Bouteflika, a second five-year term, may look like the kind of perfunctory democratic window-dressing that is sadly typical of these parts. But the incumbent's 85% landslide proves, on closer inspection, to be a pretty fair reflection of public opinion.

Not that his rival candidates' charges of fraud are wholly wrong. A government board disqualified several serious would-be contenders for unclear reasons. Mr Bouteflika's control of the state broadcasting monopoly, his influence with the large bureaucracy, and the simple existence of a 12-year old state of emergency, were certainly unfair advantages. A few restive Berbers in the Kabylia region voted with their hands, by burning ballot boxes.

Yet the April 8th poll was still the cleanest that Algeria, or, for that matter, any Arab country, has ever seen. Some 58% of the 18m registered voters (out of a total population of 34m) cast their ballots, a marked rise from previous turnouts. Foreign monitors judged the poll transparent enough to exclude the possibility of rigging on a scale wide enough to put Mr Bouteflika's majority in doubt. That is a far cry from 1999, when all his rivals pulled out on the eve of poll, protesting massive fraud.

Campaigning this time was lively, with each of the six candidates racing about the poster-plastered country to hold rallies, kiss babies and verbally savage their opponents. (One challenger referred to the vertically-challenged president as a “sectarian dwarf”.) Some Algerian journalists were so rude about the incumbent that he accused them of being “mercenaries of foreign governments” and, in a pitch to win over Islamists, “believing neither in God nor his prophet”.

The army, which scotched elections in 1991 that would have brought Islamists to power, and has often intervened since, stayed aloof. It even backed a new election law, by which Algeria's 600,000 security personnel were obliged to cast their votes alongside other citizens, rather than in front of their officers as previously.

The range of platforms was broadly representative of Algeria's political spectrum. Aside from the lone female candidate—another first for a presidential election in the region—there was a bearded Islamist, a Berber and the leader of a breakaway faction from Mr Bouteflika's party who promised faster change and greater democracy. Significantly, considering that Algeria's war was sparked by military intervention against the rising Islamist tide of the early 1990s, the Islamist candidate, Abdallah Jaballah, came a distant third with 5% of the vote.

Shortly after casting his own ballot, Mr Jaballah told reporters that he doubted the competence of the 125 international monitors who vetted the polls. Most were Arabs, “[a]nd anyone coming from another Arab country would think this was a democratic paradise,” he smiled.

Strangers to Algeria may also find it hard to see the appeal of the 67 year-old Mr Bouteflika. A member

of the hardline clique that seized power following the war of independence from France, he was foreign minister for more than 15 years before being sidelined in the 1980s. He returned from obscurity five years ago, and now promises little besides stability.

But this, for many Algerians, is good enough. “You have to understand how terrible it was. For years we couldn't go out after 4pm,” says a trader in Medea, a city hard hit by terror in the bleak 1990s. Since an amnesty coaxed some 25,000 armed Islamists down from the mountains, Algeria has become a far gentler place. The number of rebels is now believed to be in the low hundreds, and the death toll has fallen to a small fraction of the thousands who once perished every month.

The country's economic fortunes have also brightened. Growth, which stood still in the 1990s, is now a brisk 7%, spurred by oil and gas exports. The country's once-awesome debt burden has lifted. Huge challenges remain, however. Unemployment is near 30%. A housing shortage has pushed the average age of marriage into the 30s. All this has created a huge pool of unhappy youths. The bureaucracy is torpid, state industries creaky and banks take a month to cash a cheque. Vast areas of prime agricultural land lie fallow. Mr Bouteflika has plenty of work on his hands.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

South Africa's election

Thabo Mbeki's big win

Apr 15th 2004 | SOWETO
From The Economist print edition

A dull poll pleases

Get article background

IT WAS a quiet election. Mary Malubi queued for four hours in the autumn sunshine before casting her ballot, but did she mind? “No, we must vote.” Everyone else in the queue, outside a primary school-turned polling station in Soweto, was patient. Voting “is not strange any more,” said a policeman sitting nearby, and people are no longer scared.

Thousands were killed in the run-up to South Africa's first all-race general election, ten years ago. This time, newspaper editorials celebrated a “dull” campaign. The statistics on the front pages were not of deaths, but of such things as “40,000 special voting templates for the blind”.

AP

Still worth waiting for

The quiet election looked set to produce a predictable result. Early results showed the African National Congress (ANC), the ruling party, on course for a third successive landslide. Thabo Mbeki, the ANC's leader, is assured of a second and final term as president. His party looked to have attracted about two-thirds of the vote and outright control of at least seven of South Africa's nine provinces.

The only provinces where the result was not known in advance were KwaZulu-Natal and the Western Cape. In KwaZulu-Natal, the ANC was struggling to win sole control of the provincial government against frantic opposition from the Inkatha Freedom Party (IFP), which is supported mainly by rural Zulus.

Three ANC-affiliated election observers were murdered earlier this month, as was one IFP activist. Relations between the two parties are increasingly sour. Mangosuthu Buthelezi, the IFP's leader, said he would dispute a result “if there is evidence of cheating”. Was that likely? The province has a history of rigging, he claimed. Mr Mbeki pooh-poohed the allegation.

A knife-edge provincial result could provoke protests, though probably not violence on the scale that preceded the 1994 election. An extra 20,000 police and soldiers were deployed in KwaZulu-Natal, just in case. A possible result of the bad blood between the two parties is that Mr Buthelezi will lose his place in the coalition that makes up the national cabinet. An electoral pact he recently forged with the Democratic Alliance (DA), the largest opposition party, to curb the ANC's hegemony, had already upset Mr Mbeki.

In the Western Cape, meanwhile, the ANC sought an absolute majority, but was more likely to secure a plurality, and to continue to depend on its feeble partner, the New National Party, to control the provincial legislature. This was the party of apartheid, which once dominated South Africa but has seen its national support plummet to nearly negligible levels. Few will mourn its demise.

Overall, the ANC's grip on power is so secure that many observers think it unhealthy. But it depends to a great extent on its popularity, and it is counter-balanced by South Africa's vigorous businesses, courts, activists and journalists. Granted, there is no strong national opposition party. President Mbeki rubbishes the idea that democracy needs a cut-throat debate between two evenly-matched parties. But eventually, such a rival may emerge. Tony Leon, who leads the mostly white DA, energetically wooed black voters,

surrounding himself with black colleagues throughout his campaign. He aimed to double the party's share of the vote to 20%. He failed, but his support has risen for the third election running. Some day, his party may look like a plausible alternative government. But not yet.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Cyprus

A derailment coming

Apr 15th 2004 | NICOSIA
From The Economist print edition

AFP

Greek-Cypriots will say “no” to a UN peace proposal and therefore march alone into the European Union

Get article background

ON THEIR side of the divided capital of Cyprus, young Turkish-Cypriots wearing T-shirts stamped with *Evet* (the Turkish for yes) are campaigning noisily in favour of reunifying the island. Hundreds of blue and yellow balloons—the European Union colours—are floated at their rallies, in anticipation of the benefits of membership, which include some €350m ($418m) in aid which may eventually be doled out to northern Cyprus.

Opinion polls suggest that in a referendum to be held throughout the island on April 24th, some 60% of Turkish-Cypriots will back a UN plan to put the island together again—even though it will oblige them to yield control over some rich farm-land, and to send most of the Turkish soldiers now on the island back home. But in some ways, it hardly matters what the Turkish-Cypriots think. All signs are that the Greek-Cypriots will reject the UN plan, and therefore exercise their right to join the EU alone.

The buoyant mood in the north is in sharp contrast to the sullen reaction of most Greek-Cypriots to the UN proposals. Billboards in southern Nicosia, which normally promote the latest cell-phones, feature the word *Ochi* (Greek for no) against a depressing dark background. Television screens are filled with nationalist politicians rehearsing the peace plan's drawbacks. Surveys suggest that only 12-15% of Greek-Cypriots are certain to endorse it.

This is not surprising. For in an emotional address that tugged on the deepest impulses in the Greek nationalist psyche, President Tassos Papadopoulos called on April 7th for a resounding rejection of the UN blueprint. After all, he implied, Greek Cyprus will on May 1st be entering the EU as a full member—so why should Greek-Cypriots worry if other countries call them stiff-necked or intransigent? Several respected Greek-Cypriots (including two ex-presidents) have warned against a “no” vote; the Greek government said tepidly on April 15th the plan had more “pros than cons” but Cypriots must decide. The Greek-Cypriot voters seem more swayed by the rhetoric of Mr Papadopoulos, who has pointed up the plan's faults and played down the drawbacks of rejection.

To any long-standing observer of the Cyprus question, a peculiar reversal is going on. At least since the

bloody summer of 1974, Turkey and its Cypriot kin have enjoyed substantial power—thanks to a vast garrison, controlling nearly 40% of the island—while the Greek majority has held the moral and diplomatic advantage. The Greek-Cypriot administration has enjoyed a monopoly of international recognition and obtained a raft of UN resolutions calling on Turkish troops to withdraw. Whatever people thought of the events leading up to the 1974 conflict, most of the world sympathised with the 180,000 or so Greek-Cypriots who were forced to flee as Turkish troops overran the island's north, and voted accordingly at the UN.

In theory, both sides have been committed since 1977 to reuniting the island as a bizonal federation. But Greek-Cypriot sincerity was rarely tested because Rauf Denktash, the Turkish-Cypriot leader, was obligingly prepared to act as nay-sayer when a settlement looked likely.

Now the old balance is about to be reversed. The Turkish-Cypriots will earn a great many moral points by voting for the UN peace plan, while the Greek-Cypriots will make themselves deeply unpopular by their churlish rejection. But at least in their president's view, they can afford to be sanguine because they will soon enjoy the substantial benefit, which nobody can take away, of EU membership.

This is not how anyone planned things when, nearly five years ago, the Union declared that it was ready in principle to admit Turkey—and also, at a much earlier date, to accept Cyprus with or without a settlement of the island's conflict. This was a careful formula that enabled Greece to back away from its objections to Turkish membership; and was intended to promote a “win-win” solution in Cyprus which Mr Denktash, wary of any threat to his well-armed fief, could not veto.

In one of its aims, the EU strategy has partially succeeded: that of giving heart to pro-European moderates both among the Turkish-Cypriots and in Turkey itself. Recep Tayyip Erdogan, Turkey's mildly Islamist prime minister, has devoted enormous political capital to persuading reluctant generals—for whom Cyprus is a strategic prize—that they should be ready to deliver their side of any Cypriot settlement.

General Hilmi Ozkok, a dove among Turkey's top brass who is now chief of the general staff, confirmed on April 13th that the army was, despite its reservations, willing to yield to parliament over Cyprus. That means that it would be prepared to scale down and virtually withdraw its garrison of nearly 40,000 troops as it would be required to do under a settlement.

Erdogan's hopes

Better still, moderates in the Turkish-Cypriot community have been emboldened to oppose Mr Denktash, whose unrecognised republic has a habit of prosecuting his critics. That in turn has strengthened the hand of Mr Erdogan in Ankara as he tries to overcome the foot-dragging power of conservative generals. The prime minister hopes that in December he will be rewarded for these efforts by a longed-for prize: a firm date for the start of negotiations—be they ever so long—on Turkey's membership of the Union.

But if the EU hoped that by ushering Cyprus into its ranks, it would encourage moderation among the island's Greek majority, it has been disappointed. Senior figures in Brussels are already bracing themselves for a diplomatic train wreck if, as is technically possible, Greek Cyprus uses its new-found membership of the Union to block any invitation to Turkey. At that point, a half-completed virtuous circle could become a thoroughly vicious one, with Greeks and Turks slipping back into a game of mutual provocation.

One commission official called the present situation on Cyprus a “real shame” with the potential to become a “real nightmare”. Mr Papadopoulos was never going to be a popular figure in Brussels, given his history of support for Serbian nationalism in the 1990s. But he may not care: any decisions on further enlargement require his assent, and in theory he can exercise that veto if he wants.

Carl Bildt, a former Swedish prime minister and UN envoy to the Balkans, has suggested that European leaders treat Mr Papadopoulos as a pariah. Charles Grant of the Centre for European Reform, a think-tank, argues that the Greek-Cypriots will see a collapse in their “soft power”—their ability to win friends and assemble coalitions—if they are seen to abuse the privilege of EU membership.

But there is a suspicion in Brussels that if, as a result of Greek-Cypriot folly, there is a general derailing of EU policy in south-eastern Europe—and the invitation to Turkey collapses—some politicians from the Union's older states may quietly rejoice, even as they scold the Cypriots. Leaders of France's ruling UMP

party said this month they would oppose early talks on Turkey's EU membership. How well it would suit them if Greek-Cypriot hotheads did the derailing, and then suffered the effects of the crisis which this policy may trigger.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Turkish archaeology

Biting the hand that feeds you

Apr 15th 2004 | ANKARA
From The Economist print edition

A plan to display mosaics from Turkey's Pompeii has gone awry

AS AN archaeological treasure-house, Zeugma has been called the Pompeii of the east—except that it was bigger, and perhaps of even greater cultural interest, than the famous Italian town buried under ash. Its name is the Greek word for “bridge” or “joining together” and in classical times it was a nodal point between the Greco-Roman world and the cultures of Persia and Syria, as well as a crossing point on the Euphrates river.

Two millennia on, the ancient site is dividing people, not joining them up: it is the object of a bitter dispute pitting the Turkish government and David Packard, an American philanthropist, against local people in the southern Turkish town of Gaziantep. The row erupted in January when Mr Packard's foundation proposed that most of the Zeugma mosaics—whose recovery he had helped finance—be displayed in Istanbul's Topkapi Palace. With a NATO summit due to take place in that city, the proposal “seemed a good idea—and a good way to promote Gaziantep,” says Mustafa Isen, under-secretary at the Culture Ministry.

But not everybody in Gaziantep agreed. Claiming the treasures may never return, a group of NGOs in the town is campaigning to keep them at home. In March, they began a lawsuit against the Culture Ministry, saying it was violating laws against the removal of historic finds from their original sites. They have launched a separate case against Roberto Nardi, an internationally acclaimed conservator hired by Mr Packard. The Italian, who spent four years restoring the mosaics, has made a long and precise rebuttal of the allegation that he has mishandled the treasures.

But so far the NGOs seem to be winning: a court has ordered that the mosaics should remain locked up, pending a final verdict. The distrust felt by Gaziantep's residents may be understandable. None has seen the giant mosaic panels since their retrieval in 2000. That is because Gaziantep's museum was too small for them and the government has broken promises to make extra space available. Nor have suspicions been allayed by Mr Packard's offer—which he may withdraw—to build a new museum; there have been rumours that it would be reserved “for rich Americans”. Such “poison” is spread by Turkish archaeologists “threatened by the first-class experts Mr Packard has brought,” said Aykut Tuzcu, a local businessman.

Mr Packard has taken space in the Turkish press to reject the charges against his team—and to insist that, thanks to him, the mosaics have been “professionally conserved and documented to the highest standards”. He has a point. In 2000, they were nearly submerged by the waters raised by a dam. It was only after a media campaign, and Mr Packard's intervention, that the mosaics were saved. He is now said to be murmuring the adage that “no good deed ever goes unpunished.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

France's public finances

A chance or a trap?

Apr 15th 2004 | PARIS
From The Economist print edition

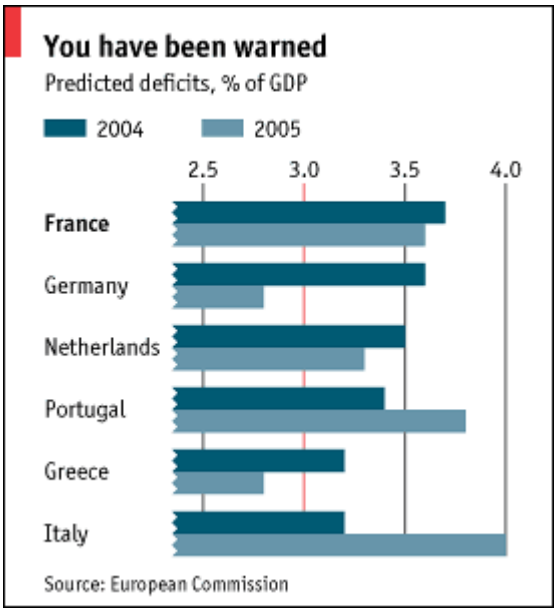
Does France's master pragmatist have a head for figures?

Get article background

THE longer Nicolas Sarkozy spends in his new job as France's finance minister, the more it looks like a trap. Last week, only days after his appointment, public-utility workers from Electricité de France (EDF) and Gaz de France (GDF) took to the streets, and caused 800 blackouts, in a protest against creeping privatisation.

This week, after meeting angry union leaders, Mr Sarkozy announced he would turn the two utilities into public companies by July—though he ruled out privatisation, and promised to protect employees' privileged civil-service status. Reassurance enough? Not likely: the unions have called for protests on April 22nd and May 27th.

Mr Sarkozy's approach to France's treasured state enterprises reflects his disrespect for national taboos. In his old job as interior minister, he broke new ground by advocating positive discrimination to help Muslims. At the finance ministry, he is, says an aide, "neither Keynesian, nor economically liberal, but pragmatic". The state is over-indebted? Then why not sell some assets? His plan, he said last week, was to manage the public finances "like a good head of the household".



Privatisation appeals because France has few other options to narrow its gaping budget deficit. This year it is set to be the worst offender among the six European countries recently admonished by the European Commission about the size of their shortfall (see chart). The government sees a deficit of 3.6% for 2004, and has pledged to bring it below the stability pact's 3% limit in 2005. But the promise looks empty.

Figures leaked to *Le Monde* suggest the finance ministry has secretly predicted a far worse gap: a 4.1% deficit this year, followed by 4% next. If events turn out this way, France will breach the limit in 2005 for the fourth straight year, confirming its busting of the pact. Though the finance ministry refuses to disclaim the figures, Mr Sarkozy still says he wants a tighter grip on the public finances. But how? Tax increases are out: he has said France is over-taxed, and President Jacques Chirac made income-tax cuts

an election pledge in 2002. Moreover, since the centre-right's rout in the regional polls last month, Mr Chirac is being nicer to special interests.

The president has promised to reverse cuts to long-term unemployment benefit and to subsidies to part-time artists and stage-hands, as well as to state-employed researchers—all of whom have protested about their plight. Jean-Pierre Raffarin, the prime minister, has also just raised the minimum wage, by 3.7% from July. So, as he prepares the 2005 budget, Mr Sarkozy must pay for those pledges too. Nor will he be rescued by growth: after narrowly escaping recession in 2003, GDP this year is set to grow by only 1.7%.

Which leaves Mr Sarkozy reaching, in part, for an old fall-back, “efficiency gains”. To set an example, he has promised to trim the finance ministry's payroll by 5,000 by 2007. Other ideas include streamlining tax collection and rationalising the state property portfolio. Eliminating waste is also expected to be central to the plans to overhaul the state health-insurance system, due before the summer. The health deficit alone is set to swell from €11 billion ($13.1 billion) in 2004 to €29 billion by 2010. Reform will again be resisted on the streets.

Hence, with so little space to move, Mr Sarkozy's bet on privatisation. He has already announced the sale of 30-40% of Snecma, an aerospace group valued at about €5 billion. Other possibilities include France Telecom, worth some €27 billion, of which 50.1% is still owned by the state; Areva, which makes nuclear reactors; or parts of Autoroutes du Sud de la France, a toll-road operator, or Air France.

Politically, though, EDF is Mr Sarkozy's toughest test. With 110,000 employees in France, many unionised, it is a formidable political force. Yet its accounts are opaque. Its employees' social committee, in charge of a huge budget, has recently been put under judicial investigation. Nonetheless, enjoying the perks and pensions of civil servants, EDF's employees distrust all promises over privatisation.

They may be right. Making the utility into a public company, even a non-privatised one, does open the way, in theory, for private shareholders. So Mr Sarkozy cannot please everybody. Officially, President Chirac put him into the finance ministry to boost the economy. Unofficially, he may have wanted to deflate a potential rival.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Romania and the EU

Don't count your chickens

Apr 15th 2004 | BUCHAREST
From The Economist print edition

2007 may be too early an entry date for a big, poor country

THERE is a public clock in the centre of Romania's capital that counts the days until 2007—the year when the country hopes to join the European Union. Its wishful ticking may help Romanians contain their frustration at not being among the eight other ex-communist countries that enter the club next month.

What if disappointment still follows? There is no “plan B” to cope with failure, say officials, almost proudly. That strategy may sound risky, but it has advantages. Romania's government has enough on its plate striving for success in 2007 (a date also held out to Bulgaria), without having to plot alternative strategies too.

The EU's requirements, swallowed whole, offer the government a ready-made programme. The need to fulfil it will provide a persuasive argument for keeping the ruling Social Democratic Party in power at the general election which is due in November.

Romania's pantomime of optimism deters EU officials and visiting politicians from questioning its ambitions, at least publicly. The only blunter message has come from the European Parliament, which said last month that Romania's accession in 2007 would be impossible unless it tackled such issues as corruption, a lack of judicial independence, harassment of the media and police brutality.

The parliament said Romania's social security system “fail[ed] completely” to help larger families, and called food safety “alarming”. But that row subsided, amid Romanian promises to improve. The European Commission still says negotiations can be concluded in time for a treaty by the end of 2005, and for accession in 2007. Romania wants the negotiations concluded by the end of this year, but that looks unlikely. Even the completion of negotiations would not mean that Romania was “ready” to join the EU in any strict sense. Nobody thinks this poor, sprawling country, whose income per person is 10% of the EU average, will have an efficient government, decent judges, a sophisticated market economy and mastery of EU law by 2005, nor even by 2007.

The idea is more that the negotiations might be deemed complete, if the EU is in an indulgent mood, once Romania has got laws and programmes in place to attack the worst of its failings, and has earmarked enough money for the years ahead to ensure that in practice things do move securely in the right direction.

Modernising Romania's legal system will mean recruiting and training about 1,500 judges, and the principles of judicial independence must be drummed into both judges and politicians—the work of five or ten years at best, not of one or two. The government needs to make its own workings more open and accountable, a tall order for politicians who mostly learnt their trade during the tyranny of Nicolae Ceausescu. It will mean, especially, more transparency in public spending, which is still used to buy loyalties and line pockets.

In December, Romania did not even bother with a tender when it gave a $2.5 billion contract to an American company, Bechtel, for a hardly-needed motorway across Transylvania. This extravagant gesture smacked less of transport planning than of a bid to bolster support among local ethnic Hungarians and to buy American friends.

But the EU has been flexible towards countries included in this year's expansion. At least two have severe shortcomings in their judicial systems; another one or two, notably Poland, may elect dangerous populists. Why shouldn't Romania have similar indulgence?

One answer may be that, after struggling to digest so many ill-equipped countries this year, the EU will be in no hurry to repeat the experience. Early clashes with Poland have brought home the risks of letting a big but very needy country into the EU: it becomes aggressive and defensive, fearing that others will take advantage of its weakness. Romania might follow suit. If the admission of Romania in 2007 comes to look too daunting, the EU can slow the negotiations, raising questions and doubts until the moment for signing the accession treaty passes. (It would have to decide then whether to set back the admission of Bulgaria also.) Romania and the EU should think more more about this possible outcome. Delaying the next enlargement until, say, 2009, would give Romania more time to complete badly needed reforms. Fears that this might backfire, by demoralising Romania so much that its reforms unravelled, are probably misplaced—especially if a later date were offered as a firm promise.

For the Romanian government, a delay might even be welcome, so long as it became known only after November's election. The ruling Social Democrats will campaign as the party capable of assuring EU entry. If the date then slips to 2009, they can campaign on the same platform when the next election comes round in 2008. But a botched accession in 2007 would make the 2008 election very sticky. If the centre-right opposition wins this year's election, it should be happier still. It will get no blame for the deferral and will win time for reforms. The clock can be reset, without wrecking the mechanism.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Russia

Playing politics from prison

Apr 15th 2004 | MOSCOW
From The Economist print edition

Mikhail's mysterious missives

AP

WHEN Russians want to study their country's power struggles, they no longer bother to follow parliamentary debates or even Kremlin reshuffles. Not for the first time in Russia's history, the biggest contests are being played out in court-rooms and jails. As a criminal case against one of Russia's richest men, Platon Lebedev, heads to court on April 15th, his business partner—and the former head of the Yukos oil company—Mikhail Khodorkovsky has raised his political profile by issuing a series of messages from prison.

Both defendants have been accused of fraud and tax evasion, and both will plead innocent. It is widely assumed that these charges were brought as a way of penalising Mr Khodorkovsky and his entourage for breaking President Vladimir Putin's rule: tycoons must stay out of politics if they want the state to lay off their businesses. No surprises in all that: the real mystery for Russia's tea-leaf readers is what exactly Mr Khodorkovsky means by the curious communications, calling for Russians to forgive one another and co-operate for the motherland's sake, that emanate from his cell. Are they an indication that the 40-year-old oil baron has some new strategy for the future of Russia which he hopes to implement? Has Mr Khodorkovsky bowed to the Kremlin as part of some grand bargain? Among Mr Khodorkovsky's messages was a letter published in March in the business daily *Vedomosti.* It blames Russia's problems on the “liberals” who held political and economic power in the 1990s; and it urges firms to pay more tax so as to lend legitimacy to the idea of privatisation. It half-supports Mr Putin, calling him more liberal and democratic than 70% of Russians.

But the tycoon's lawyer, Yuri Schmidt, warns against reading too contrite a spirit into Mr Khodorkovsky's words. “I saw none of the penitence, none of the compromise that many ultra-liberal analysts saw,” Mr Schmidt says.

If any deal has been struck, there is no sign of it at the prosecutor-general's office, which still wants to bring the Khodorkovsky case to trial. Some people fear a broader witch-hunt against over-mighty tycoons. But Mr Putin insists he is only targeting wrong-doers, not free enterprise.

The Kremlin has the tools to go after other businesses if wants to. That is clear from the charges against Mr Lebedev: the sharpish business practices alleged in a 55-page summary of the indictment, which was published by the prosecutor general's office, were common in the early 1990s. If Mr Lebedev is guilty, then so were most Russian proto-capitalists.

But for now, investors seem more excited by Russia's growth, buoyed by high oil prices, than fearful of the political future. The whole Russian market as well as Yukos itself took a hit five months ago when Mr Khodorkovsky was arrested, and its plan for an $11 billion merger with Sibneft—another oil major—was mired by Kremlin intrigues. (Simon Kukes, the Yukos chief executive, insisted on April 14th that the merger would be completed unless any “interested party” raised formal objections.) In recent days, the RTS market index has roared ahead and shares in Yukos were near their pre-arrest highs. That is a fine performance for a firm whose chief shareholder, Mr Khodorkovsky, faces charges which could send him to jail for ten years. Maybe investors see an equally good chance that in a decade's time he will be Russia's president.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Charlemagne

Dancing an Irish jig

Apr 15th 2004
From The Economist print edition

EU newcomers will mimic the nimble Gaels—if they get the chance

EVEN by local standards, it will be a time of *craic* and conviviality to remember. At the beginning of May, ten newcomers to the European Union will mark their first day as members of the club by joining the 15 older ones for a hearty celebration—in Dublin. The venue could hardly be more appropriate. For anyone talking to politicians from the new member states will know the refrain: “We want to be like Ireland.”

The Irish-wannabes in central Europe are not thinking about the delights of smoke-free pubs or Celtic music. Ireland has become “Exhibit A” for those who believe that entering the Union can make you much richer. When Ireland “joined Europe” in 1973, its per-capita income was just 62% of the EU average; by 2002 it was 121%. Pat Cox, the Irish president of the European Parliament, says membership “turned us from a stagnant, backward, failed part of the British regional economy into a modern and prosperous European country.”

Yet EU membership does not automatically confer riches. Greece had a GDP-per-head of 64% of the EU average when it joined in 1981, and by 2002 the figure was only about 70%. Even in Ireland, the miracle took a while coming. In 1987—almost 15 years after joining—the country was facing double-digit unemployment, mass emigration and a public debt of over 120% of GDP. But by slashing taxes and the state's share of the economy, the Irish were able to exploit their access to the EU market and encourage a torrent of foreign direct investment. By 1998 American multinationals accounted for 70% of Irish exports. The top corporate tax rate, once over 40%, now stands at 12.5%; the state's share of GDP, which hit 54% in the 1980s, is now down to 33%. Unemployment is less than 5%.

These lessons have been eagerly absorbed in the new member-states, where flat taxes and small government are now all the rage. Estonia led the way by introducing a flat corporate tax rate in the mid-1990s. Now Poland, Hungary and Latvia have all cut corporation tax to below 20%. Slovakia has introduced a 19% flat tax for both corporate and personal income. Combine low taxes with good basic education and relatively low wages—Slovakian workers' wages are around 20% of those in Austria—and you have a very attractive package for investors. Slovakia, whose population is just 5.4m, is fast becoming one of the car manufacturing centres of Europe: Volkswagen, Hyundai and Peugeot have all invested. Ivan Miklos, the Slovak finance minister who has masterminded his country's reforms, says confidently: “Foreign direct investment into Slovakia is going to be even higher soon, because investors will have the added economic and legal certainty of being part of the EU's internal market.”

Ireland had some advantages—an English-speaking population and close ties to the United States—that the new members of the EU cannot replicate. On the other hand, countries like Poland and Slovakia are nearer the big markets of western Europe than Ireland is. The economies of the new member-states grew by an average of 3.7% last year—a much healthier rate than the 0.4% average experienced in the euro-area. The central Europeans will have to keep up this pace for many years, if they are to achieve their ambition of becoming as rich as western Europe. The current wealth gap is so large that the Economist Intelligence Unit, our sister organisation, has estimated that—even if they grow at around 4% a year for the foreseeable future—it would take Slovakia almost 40 years to catch up and Poland almost 60 years.

Fear of high-fliers

Such rapid rates of growth, if they are achieved, would provide healthy new markets for west European companies. Yet there is now a distinct whiff of fear among the current members about competition from central Europe. When Ludwig Georg Braun, the head of the German chambers of commerce, recently

advised his members to invest in central Europe rather than “wait for better policies” in Germany, he was denounced as unpatriotic by Gerhard Schröder, the German chancellor. Austria has announced that it will cut its corporation tax to 25% next year from the current 34%, citing the competition from neighbouring Slovakia. The Austrians say they welcome the competition. But not everybody in the EU is so sanguine. Guy Verhofstadt, the Belgian prime minister, has revived the idea of a minimum corporate tax rate for the whole of the EU—and added a nasty new twist, by suggesting that countries that refused to co-operate could be deprived of the EU's regional aid to poorer places.

Such tax harmonisation, however, would have to be agreed unanimously in the new EU—and it is hard to see why new members should agree to hobble themselves. The real threat to the Irish ambitions of central Europe may end up being home-grown rather than imported from Brussels. Economic reform in central Europe inevitably creates losers as well as winners. Workers in uncompetitive old industries or over-staffed state bureaucracies lose their jobs. The middle class may find that prices are rising, as indirect taxes go up to compensate for cuts in corporate and personal taxes.

The political fallout can be nasty. In Poland, the prime minister has just been forced out of office and Andrzej Lepper, a potato-throwing populist, is riding high in the polls. In Slovakia, Mr Miklos insists bravely that “deep structural reform is only possible with deep political will”. But while the finance minister's determination is unquestionable, ordinary Slovakians show signs of rebellion. In the first round of the recent presidential election, they gave first place to Vladimir Meciar, a backward-looking nationalist who is deeply suspect in the rest of the EU. If populists like Mr Lepper and Mr Meciar come to power in central European countries, investors are liable to take fright. For the Irish recipe was not just low taxes and small government. It also contained another vital ingredient investors need to be able to take for granted—political stability.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Pensions

On the cheap

Apr 15th 2004
From The Economist print edition

The government is not owning up to the full cost of protecting the promises made by company pension schemes

THEY are meant to be the Rolls-Royces of the pension world. But company pensions, expensive to provide and seemingly so safe and solid, can turn out to be financial death-traps. Since the collapse last month of Mayflower, a British bus-building company, many of its 3,400 workers are facing big holes in pensions supposedly tied firmly to their final salaries. They may not do as badly as the former workers at the Cardiff plant of ASW, a steel company, who will collect less than a fifth of the pensions they were promised, according to Ros Altmann, a pension consultant. But they join some 60,000 employees hit this way in the past few years.

There is the potential for much more grief. Currently, Britain's company pension schemes offer benefits worth £850 billion ($1.53 trillion), but the assets backing them are worth only £560 billion, according to Mercer, an actuarial firm. That hole stems from the three-year bear market in equities plus the rising costs of annuities.

The government's partial solution to the problem is the Pension Protection Fund (PPF), roughly similar to America's Pension Benefit Guaranty Corporation. The British scheme provides compensation worth 90% of benefits to people of working age, with a maximum payout of £25,000 a year for someone retiring at 65; less at earlier ages. Inflation-linked rises thereafter will be significantly less generous than for company pensions.

A levy on private occupational schemes will raise £300m a year towards the new fund. Half of this will come from a flat-rate premium, initially set at £10 per member. The other half will come from risk-based premiums, in which firms with under-funded pension schemes pay more than those with better-funded ones.

That sounds a good deal in the circumstances. Too good, say independent pension analysts. Deborah Cooper, an actuary at Mercer, says that to provide cast-iron benefits, the PPF needs £600m a year. But in its first year of operation it will receive just the flat-rate premium, worth £150m. Other actuaries agree: “The PPF is getting off to a crippled start,” says Raj Mody of Hewitt Bacon & Woodrow, who fears that there may be a bulge of claims in the first year, when there is least money to pay out.

Another big worry is how the PPF will invest its money. The plan is that it should be run like a pension fund, investing in equities as well as bonds. Leaders of the actuarial profession have written to the government, expressing their concern about this approach. “If the government doesn't want any risks with the PPF then it should run it like an insurance company and invest in bonds,” says Michael Pomery, president-elect of the Institute of Actuaries. However, that greater security would push up the cost of the levy.

The main concern, though, is ensuring that private pension schemes based on final salaries are properly funded, argues Michael Orszag, research director at Watson Wyatt, an actuarial firm. This will be doubly important once the PPF comes into existence. Insurance creates “moral hazard”: employers may put too little into the pension fund and make risky investments in the knowledge that someone else will foot the bill.

In short, the PPF appears to be offering more than it can provide. Since many of the workers covered will be too young to receive pensions, it should be able to pay immediate claims from its cashflow—the annual levy and income from pension-fund assets of insolvent companies. However, Ms Cooper of Mercer estimates that after ten years the PPF is likely to have built up a deficit—the excess of claims over its

assets—of £3 billion in today's money.

The government is ruling out any use of taxpayers' money to bail out the PPF if it runs into trouble. It retains reserve powers to reduce the level of compensation if there are large claims against it. But John Ralfe, an independent pension consultant, thinks this stance will be politically untenable. “When the cupboard is bare,” he says, “who do you look to? You try telling aggrieved pensioners the PPF is not an arm of government.” Mr Mody agrees: “If get-out measures are built into it, this defeats the political purpose of setting up the PPF in the first place.”

The gap between the PPF's aims and means leaves the government open to the charge that it is trying to offer company-pension insurance on the cheap. In the short term, this approach will probably be feasible: pension obligations stretch a long way into the future. However, it stores up trouble for future taxpayers. As so often when politics meet pensions, the temptation to go for the quick fix seems to have proved irresistible.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Animal-rights extremism

Playing terrorists

Apr 15th 2004
From The Economist print edition

Adaptation and survival in the animal-rights kingdom

PA

Greater hooded activist, now rare

EXCREMENT through the post in the morning and a rape alarm through the letter-box at night; a can of paint stripper poured on the car and balaclava-shrouded eyes at the window to frighten the children: workers at companies who use animals for medical research have all this to look forward to when they down their pipettes and go home.

On April 17th, designated by protesters as “World Day for Lab Animals”, several hundred people will march through Cambridge protesting against Huntingdon Life Sciences (HLS), which does research for drug companies. Most of the crowd will be lawful. But there will also be a couple of dozen who repeatedly break the law to harass the company. Mainstream animal-rights activists shun this group. So does an increasingly terrorism-intolerant public. So why are these predators on science and reason not yet extinct?

Part of the answer is evolutionary adaptation to a weaker position in a harsher environment. Anti-vivisection rallies in the early 1990s attracted thousands, but many have since been put off by the violence and fanaticism of the hard core. The remaining militants have now figured out that outright violence loses sympathy and gets them arrested. So no real bombs have been sent to researchers for a while, though pretend ones abound. Physical assaults are now rare, while threats of thuggery are more common. The key to survival is to be extreme enough to attract money from the small number of supporters who want violence, while staying anonymous enough to evade the police.

The choice of terrain and prey has changed too. Extremists harass researchers and other workers not at their well-guarded workplaces, but at home, which is hard for the police to cover. And instead of attacking labs, which must stand firm to stay in business, the new target is any firm that supplies services to animal-research companies. Tactics include blocking communications with constant phone calls, e-mails and faxes, and attacking company property. Stop Huntingdon Animal Cruelty (SHAC) boasts that 25 suppliers have withdrawn services from HLS in the first three months of this year.

The scalps include Sunlight, a laundry company, the Cambridge Pet Crematorium, provider of last rites for guinea pigs, and John's Taxis, a local cab firm. Even large companies have proved surprisingly weak-kneed. Securicor, a security firm, says its contract to guard HLS has “ceased”. Travis Perkins, a construction materials company, has pulled out of a project to build a new bioscience research facility for Oxford University. Going after suppliers in this way raises costs and makes doing business difficult.

This is bad news for drugs research in Britain, a business that turns over £9m ($16m) a day. Though no companies have yet relocated abroad (partly because the extremist groups are international too), the Association of the British Pharmaceutical Industry says it knows of cases where drug companies have placed research elsewhere to avoid harassment. This is embarrassing for a government that is anxious to portray Britain as research-friendly and has pledged to spend an extra £1.25 billion a year on science by 2005-06.

The industry wants new laws to deal with the problem and points to America, which brought in special provisions against animal-rights extremism under anti-terrorism legislation passed in 2002. That shouldn't be necessary: the problem is weak wills, not weak laws. The police already have extensive powers to deal with threatening behaviour.

Judges and magistrates are now, belatedly, being encouraged to treat each incident as part of a wider campaign, rather than as isolated breaches of public order laws. Nevertheless, it is hard to imagine political or religious bigots getting away for so long with this level of intimidation and harassment if they targeted, say, rabbis and synagogues. But, for the moment, workers in white coats and their employers don't seem to matter that much.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

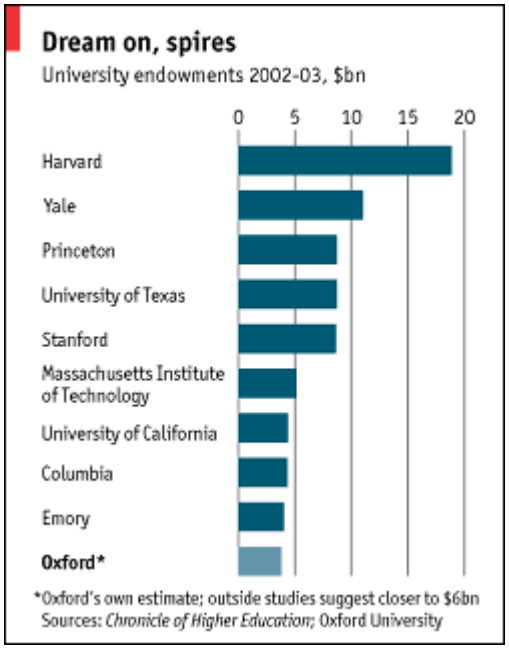
University fundraising

Grotty givens

Apr 15th 2004
From The Economist print edition

Universities' fundraising woes reflect the clash of hope against reality

Get article background



WHY are Britain's needy universities so bad at fundraising? Oxford and its colleges pull in around £65m ($118m) a year to add to an endowment conservatively valued at around £2 billion. That is riches by British standards but less than a quarter of Harvard's $558m haul last year on top of an endowment of close to $20 billion. At King's College London, one of Britain's top dozen universities, the five-year fundraising target is a paltry £44m.

Reasons for this include fewer rich people in Britain, no big recent tradition of philanthropy, and a social convention that asking directly for money counts as boorish. A bigger problem, though, is the government. Although tax treatment of charitable giving is similar on both sides of the Atlantic, university finance isn't. British universities are largely state-financed, and state-run. Donors shy away from any risk that their generosity will just make up for government shortfalls—or worse, be maladministrated by bureaucrats.

British universities have persuaded the government that tuition fees should rise to up to £3,000. But David VandeLinde, vice-chancellor of Warwick University, says the new bill may have given the impression that the government is "well on its way to dealing with all the financial woes of our universities. It is not."

None of this helps. But the biggest failing lies with the universities themselves. The vice-chancellors who run them are ill suited (sometimes literally) to schmoozing millionaires. Compared with America's armies of fundraisers, the British efforts are tiny—King's employs just 13 people for development and alumni relations combined. The pitches for funds too often sound modest and drab. "What appeals to a donor is the chance to start something or to complete it, not just to keep it going," says one multimillionairess who has given to both British and American universities.

British universities are worse at integrating donors into university life, she says. An advisory committee for a library at, say, Harvard, includes donors and university high-fliers, all hobnobbing over an interesting project. By contrast, British universities may plunk big donors on to a "formalistic and horrible" board, she says. "At Harvard, they are made to feel they contribute more than the money."

Then there is the question of competence: whereas American universities manage their money professionally, the British record is more mixed. University administrators tend to like new buildings; donors may be more interested in supporting bright but needy students.

To be fair, British universities are still learning, having begun serious fundraising only in the 1990s. One idea is to recruit more experienced staff from charities and the arts world, says Rebecca Williams, development director at King's. Warwick and the London School of Economics have both hired fundraisers from across the Atlantic. Cambridge has high hopes for its new vice-chancellor, Alison Richard, poached from Yale. Americans are in overall charge of London Business School, Warwick and (come September) King's. Oxford has a ten-person development office in New York and rotates British staff through American training courses.

But the sneaking suspicion is that good fundraising is a symptom of success, not its cause. If so, Britain's tatty universities and demoralised dons may have a long wait for the hoped-for megabucks.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Criminal justice

Charging ahead

Apr 15th 2004
From The Economist print edition

Police muddles mean botched prosecutions. Time for reform

Get article background

GIVEN the choice, a criminal would prefer to be chased by a lawyer than by a police officer. But he would doubtless prefer a copper, not a lawyer, to handle the paperwork afterwards. For despite their crime-busting skills, the police are prone to overlook gaps in evidence, to bungle procedures, or simply to charge a suspect with the wrong offence. That's good news for criminals, and bad for justice.

In most countries incompetent coppers wouldn't matter: state prosecutors or attorneys set the legal wheels turning. But in England and Wales, oddly, suspects are interrogated and charged by ordinary police officers. Lawyers of the Crown Prosecution Service (CPS) typically learn the details of a case only once charges have been brought and all evidence collected.

All too often, they find that the case is too flimsy or ragged to pursue. Of the roughly 1.4m cases handed to the CPS annually, the rate at which offences are brought to court has declined, from 78% in 1999-2000 to 73% last year. That leaves a “justice gap” of some 400,000 cases.

Peter Lewis, joint director of the CPS's charging programme, suggests two reasons. First, he says, following the law has become much more complicated. Blame for that lies with politicians: Labour has fiddled with the criminal justice system more than a dozen times since it came to power in 1997. Second, rising police numbers mean more inexperienced officers. So while decisions are more complex, the people making them are less expert.

Moreover, the police frequently have other priorities in mind. Jackie Kaur, a prosecutor who has worked with officers in Kent, reports that coppers tend to over-charge, perhaps for the sake of effect: choosing actual bodily harm, for example, when the evidence only supports the lesser charge of assault.

Then there is hastiness. Particularly in more serious cases, the police are so keen to get things rolling that they often overlook the need for identity parades or DNA evidence. By the time prosecutors spot the missing links, memories are dimmed and crime scenes contaminated.

But recently this dismal picture has begun to brighten. Under a new government scheme, prosecutors have started working in police stations in order to help the bobbies get the paperwork right. An after-hours telephone service, “CPS Direct”, offers back-up advice. This summer the new arrangements will be standardised and extended to most police forces.

So far, results have been good. When the new methods were tested in selected areas in 2002, the proportion of cases where charges were changed or dropped fell from 51% to 18%, while conviction rates rose by 15%. And officers have warmed to having CPS lawyers in their midst. Relations between the two tribes used to be poor, with police jokes about the “Criminal Protection Society”. Some prosecutors are now giving pre-arrest advice: telling police who are planning a raid, say, what sort of evidence they need to collect.

Such arrangements are common in other countries, and not unknown in England and Wales. A similar system existed 20 years ago but was ditched in the cause of fairness and efficiency. The police prosecuting solicitors, as they were known, were seen as too close to the constabulary, cutting corners and bending evidence.

So reform is long overdue. But there are dangers ahead. In pilot schemes, prosecutors have been able to

compromise to win police trust—for example by letting them skip hurdles that are required by the rules but not necessary to bring a particular case to court. That will be impossible once the scheme becomes statutory. Prosecutors will require police to collect every scrap of evidence (including notoriously slow DNA matches) before allowing them to charge. That is bound to increase frustrations and slow down the process.

Another looming problem is a Home Office target that requires the CPS to bring 1.2m offences a year to justice by 2006—independently of the level of crime or even numbers of arrests. If red tape and government meddling derails the promising reforms to criminal prosecutions, it would, sadly, not be new or surprising.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Safety at work

The real challenges

Apr 15th 2004
From The Economist print edition

Britain's most-mocked quango makes some errors. But it's facing the right way

HAS the Health and Safety Executive (HSE) lost its marbles? It prosecuted London's police chief last year because two officers fell through roofs, one to his death, while investigating break-ins. It failed, and was vigorously rebuked by the trial judge. Yet according to the quality broadsheets of the *Telegraph* stables, it's at it again, this time telling mountaineers they must use two ropes, not one, when climbing a rockface. Maybe even scaffolding will be necessary. Can you believe it?

Don't: this latest alleged folly, like many earlier ones—crash helmets for tight-rope walkers, hand-rails for army assault courses, or closing London's Tower Bridge because of a demonstrator prancing on a nearby crane—is a media fantasy. Britain's safety-at-work body may go over the top at times, but not as often or as far as its critics claim. The safety regime's real problem is different: set up for an industrial society, it works in one dominated by services.

For all the tales of woe that any small businessman will tell you, the big issue, says the British Chambers of Commerce (BCC), a business lobby group for small and medium-sized firms, is not so much the rules but the changes in them: the BCC's members can't afford the time, or in-house experts, to track every change. And the aggravation stems not from zeal (prosecutions are in fact growing fewer), but inconsistency: the requirements seem to vary from one inspector to the next.

The Engineering Employers' Federation says much the same. It dislikes changing or over-complex rules, especially some new, or coming, European Union (EU) ones on noise, vibration and electromagnetic and optical radiation. But sensible rules on health and safety, in which bosses and employees do share an interest, it says, are “a damned good thing”; it accepts that the HSE inspectors have a real job, and mostly do it reasonably; and after some early coolness, it gets on well enough with Bill Callaghan, the former Trades Union Congress economist who now chairs the tripartite commission that oversees the HSE.

Neither employers nor unions dispute that the regime, by and large, works. In the industries most concerned, employment has fallen some 40% since the HSE was born in the mid-1970s, but deaths by 70%, to about 225 a year today. And Britain's figures are far better than the EU average. Nearly all the HSE's work these days is to advise and prevent, not to punish: its 85,000 inspections each year lead to about 13,000 “enforcement notices” and only 1,000 or so prosecutions. Safety awareness, aided recently by rocketing insurance premiums, has spread: “You see far more hard hats these days,” says one employer.

The shift from manufacturing has helped cut injuries and deaths: only 7m of the 40m working days lost each year are due to accidents, compared with 33m to “stress” and similar ailments. But that calls for new diagnostic skills, and brings new suspicions: the roofer who falls 50 feet is a corpse, but the poorly seated keyboard worker with repetitive strain injury may look to his boss like a malingerer.

A second problem is that the safety regime is not one system but two. The HSE oversees farms and building sites (the two most lethal workplaces by far), mines, factories, railways, chemical works and the like. But warehouses and shops, offices, kitchens and other rising areas of the economy are the job of local councils.

That means over 400 authorities, most of which have little interest in workplace health or safety. The HSE has 1,100 on-site inspectors for 740,000 workplaces; councils have the equivalent of 1,200 full-timers (many in fact part-time, their main job being trading or food standards) for 1.2m workplaces. The HSE may inspect an engineering workshop one year in eight; the council gets round to a graphics studio

one year in 12. A workstation isn't a lathe, but is it “over-enforcement” to leave the workers' seating, lighting and desk heights uninspected for so long? No, says the TUC's safety chief, Hugh Robertson.

The council averages, in fact, conceal huge variation. The keenest tenth of councils inspect from a third to two-thirds of the premises in their area annually; the least zealous tenth fewer than one in 20.

Does that matter? Service-sector deaths are indeed few, only about 75 a year and the risks of injury look slim too. But many injuries that are in law “reportable” are never reported: the real total, on survey evidence, may be 2½ times the official figure. Even so, councils issue over 5,000 enforcement notices a year, and bring some 300 prosecutions.

Health is trickier than safety. Asbestosis or “vibration white finger” are diagnosable disorders. But what about back pain? Any hospital nurse knows it as a genuine, work-related condition, often due to shifting heavy patients; any GP has met it as a skivers' charter. And stress? A high achiever's pleasant buzz is someone else's unbearable pressure. Some 500,000 people tell surveys their work has hurt their back, their nerves or suchlike in the preceding 12 months. New surveys this year and next will shed more light on them—but little, probably, on how far regulators should go to prevent them.

In sum, the health and safety regime, shaped for a world of industry and injury, faces a new one, that of services and (real or not) stress. Much must change, says Mr Callaghan, whose commission is meant to oversee both halves of the system. Local councils, broadly, agree. He and they are now trying to redefine who does what and how, jointly, to get the best results from slim resources. For once, employers and unions agree on the objective. The details will be another matter.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Strikes

The state sector wants more

Apr 15th 2004
From The Economist print edition

Trade unions sniff public money—and political opportunity

CIVIL servants go on strike, a union representing prison-service workers sends out ballot papers for one, the main rail union gets set to do the same, two teachers' unions threaten to follow suit unless... Is New Labour Britain heading for a summer reprise of old Labour's "winter of discontent" in 1978-79, when rubbish was piled up in the streets and corpses were turned away by pickets at the cemetery gates? The answer's "no"—not least thanks to Margaret Thatcher's union-bashing in the 1980s. But for certain the public-sector unions have smelt both money and an approaching general election.

Of this week's labour news, the strike that actually happened mattered least. Whether it was 90,000 workers (as their Public and Commercial Services Union said) or 40,000 (said the Department for Work and Pensions) who came out at employment exchanges and benefit offices, the unemployed have learned to wait, and most pensioners were still getting their money on time. As for this union's government statisticians, and some prison-service office staff, who also struck, or the prison electricians and boilermen now being balloted by their Amicus union—well, the average Briton cares little for seasonally adjusted GDP statistics and even less for the flow of prison porridge. It would take more than short-lived walkouts like these to hurt the government.

Teachers' strikes would be far more disruptive, if they actually happen. For the National Union of (mainly primary school) Teachers the issue is the use of classroom assistants; for the (mainly secondary school) National Association of Schoolmasters/Union of Women Teachers it is the notion of a six-term school year. But the background, in both unions, is one of a profession in deep discontent. The NUT's retiring general secretary, Doug McAvoy, gave ferocious voice to it in his conference speech this week, denouncing private sector involvement in education (if only). But even apolitical teachers feel messed about by the government.

The worst disruption of all could come from the strike that arguably has least justification. As the state hurls billions—far more than in the days of nationalisation— at the railways, the largest union there, the RMT, wants to enlarge its members' share of the loot. So it is balloting 7,000 key workers employed by Network Rail, the state-created "company" that operates the signals and track.

A strike there could stop most of the trains in Britain. The issues, says the union, are both what it calls "the worst pay offer in the industry" and the closure to new workers of a typically generous pension scheme still enjoyed by existing employees. That's a familiar move by now in the private sector, but not for state employees, which is what Network Rail's people in reality are. The bosses point to various offers they have made, and are plainly ready to improve, in talks that are still under way.

For the government there is a nasty thought, and all trade unions know it. Fairly or unfairly, the strikes of 1978-79 helped to cost Labour the next election, and set the stage for 18 years out of power. And today, as then, many unions are too fed up to care if Labour survives in government or not. So expect more strikes.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

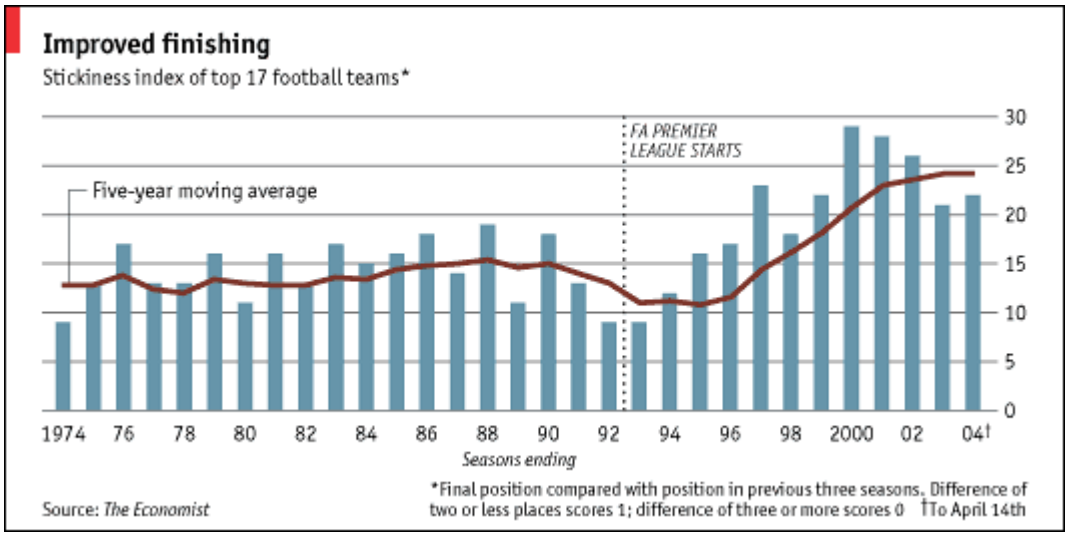
PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Premier League football

Game of one half

Apr 15th 2004
From The Economist print edition



Football may be the beautiful game, but it is becoming a less competitive one

Get article background

THERE is plenty of movement on the pitch, but precious little off it. That is the story of top-level professional English football, where the best teams hog the top places and there is not much movement even among lowlier outfits. As this football season nears its close, Arsenal and Manchester United are in first and third positions respectively in England's Premier League. Neither has finished below the top three spots at any point in the past seven years. That's not unprecedented: Liverpool achieved the same level of dominance in the 1970s and 1980s. What is new is that so many teams, even less glamorous ones, have equal staying power.

The chart above shows the degree of stickiness among the top 17 clubs in the Premier League (those that are not forced out of the league through relegation) over the past 30 years. A team's position at the end of each season is compared with its achievement in the previous year, as well as its position two and three years ago. The chart shows that stickiness—defined as movement of less than two places in either direction—remained constant between the early 1970s and mid-1990s, and then increased steeply.

A cluster of teams just below the elite level and a group of “mid-table mediocrities” account for much of the inertia. Liverpool's glory days may have passed, but the club consistently finishes in the top six positions. And, while it may be cold comfort to supporters of those teams, Middlesbrough and Tottenham Hotspur have come to dominate the middle of the league the way Arsenal and Manchester United rule the top.

Why the lack of movement? Fans of consistently successful (or relentlessly mediocre) teams usually point to the performance of managers and star players. A better indicator is financial. Success in the Premier League correlates closely to wage spending. During the past decade the gap between the flushest and stingiest teams has widened as total spending has risen from below £100m to £750m, according to the Sport Business Group at Deloitte & Touche, an accountancy firm.

Top teams can manage the larger bills because they earn income from European competitions for which they routinely qualify, and because they can sell more seats and shirts. Teams at the bottom cannot; to make matters worse, they are periodically impoverished through relegation.

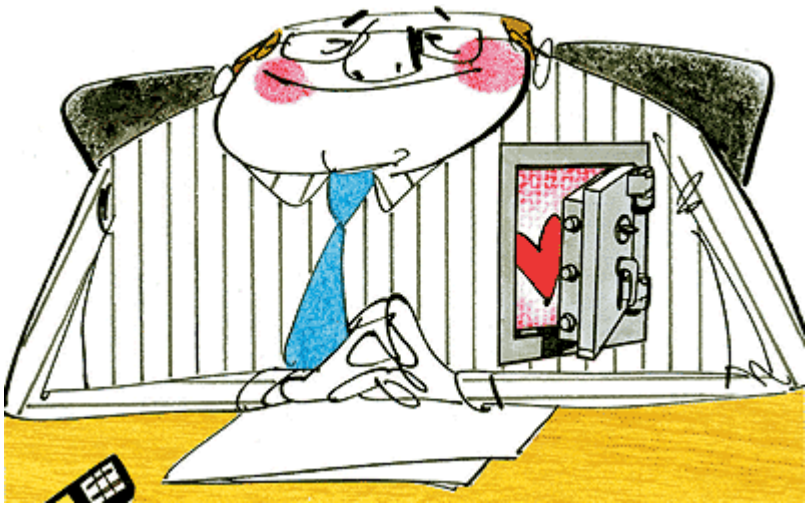
Oddly, the growing predictability of English football does not appear to be putting off the fans, who (in contrast to their European counterparts) have attended more games every year since 1995. A moderation of expectations is the likely explanation. When a star team like Manchester United is seen as a shockingly abject failure for managing only third place, who needs more competition?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Trust me, I'm a banker

Apr 15th 2004
From The Economist print edition



Banks have rediscovered the virtue of knowing their customers, writes Patrick Lane

BUT for Fritz Vogt, Gammesfeld would be an unremarkable place, scarcely worth a dot on the map. It's a pretty spot, but it won't keep you long. If you allow yourself a stroll through the pristine graveyard by the medieval church, you might need all of 15 minutes to walk around it.

However, this village of 530 people in south-western Germany has a claim to fame. Its bank, run by Mr Vogt—and by his father and grandfather before him—is the smallest in the country. The Raiffeisenbank Gammesfeld, one of Germany's 1,400-odd co-operative banks, has a mere *euro*15m ($19m) in assets. Mr Vogt is the only employee. There are no automatic teller machines (ATMs), in fact no computers at all. Mr Vogt records everything by hand, with the help of an electronic adding machine and a formidable old typewriter. The cost of new technology is not justifiable for such a small bank, he says.

Mr Vogt calls himself an “anti-capitalist”. He believes that money is for transactions, not speculation, so his 600 customers cannot invest in the stockmarket over his counter. They have to put up with other little inconveniences too. Although they have plastic cards, they must pay a fee if they withdraw cash from machines at other banks, including co-ops. Still, there are ample compensations. The Raiffeisenbank Gammesfeld pays a generous 3.0% interest on savings, regardless of the size of deposit, and charges a mere 4.0% for mortgages and 5.0% for other loans. No wonder the balance sheet grew by 11% last year. Outsiders often ask to open accounts, but are turned away: Gammesfelders only.

It would be easy to dismiss the Raiffeisenbank Gammesfeld as an archaic throwback, kept going only by an old man's enthusiasm. Yet many big banks are trying to recapture something that Mr Vogt, now 73, has never lost: the human touch. He knows all his customers, which is more than most bank managers can say these days. Sit in the bank for half an hour, and you might imagine yourself in a corner shop. Customers come in to a friendly welcome, chat while he counts the cash and leave with a cheerful *ade*. Local knowledge also gives him a fair idea of credit risk. Mr Vogt cannot recall any bad debts—although in 1995 the bank was defrauded of DM55,000 (then $38,000).

An automation too far

Now bigger banks too are rediscovering the value of the personal touch. Until recently, the trend was to automate everything. Branches were out of fashion, because people and buildings were thought to be too expensive. Customers were invited to use ATMs and discouraged from bothering the staff: for a while

Bank One, an American bank, even charged for using human tellers. Customers were encouraged to bank by telephone—and would find themselves speaking to someone not in their local branch but in a call centre hundreds of miles away. Some American and British financial companies are making themselves more remote than ever by shifting their call centres to India. The internet seemed to complete the depersonalisation of the industry.

To be sure, banks have not abandoned the telephone or the internet. Both have made everyday retail transactions cheaper for the banks and more convenient for millions of customers. Many people have had no need to go near their branch in years. They are quite happy to be charged to use a teller, because they never do.

The beauty of branches

For all that, the branch has been making a comeback. Telephones and computers are fine for checking bank balances or making payments, and they can be powerful ways of selling standardised financial products. Direct Line, owned by Royal Bank of Scotland, has made a great success of selling insurance by telephone; ING, a Dutch bank, is doing well with telephone and internet savings accounts in several countries.

However, these technologies are much less good for selling products of any complexity. Most people prefer to discuss mortgages, mutual funds and so forth face-to-face. Moreover, banks these days want potential customers to do more than open a new current account. They aim, in the industry jargon, to maximise their “share of wallet” by selling a whole portfolio of services, ideally after a thorough review of all a customer's financial affairs. People are much better at that than machines are.

In the United States, the number of bank branches has been on the increase for several years, even though the number of banks has been falling. Elsewhere, branch numbers are declining, but banks are nevertheless beginning to rethink how branches should be used. They are less inclined to whisk promising managers off to head office and more willing to leave them in the field where they have direct contact with customers.

More generally, many bankers now like to stress the “retail” bit of retail banking. Some talk eagerly about the lessons they have learned from Wal-Mart. Others refer to themselves as “retailers” rather than bankers. The head of retail at one British bank, HBOS, used to work for Asda, a supermarket chain owned by Wal-Mart; the man in charge of branches at Abbey, another British bank, came from Woolworths and spent many years at Dixons, an electrical-goods retailer. Some banks have changed the design of their branches to make them feel more like shops or showrooms. Marketing emphasises nearness to the customer: Commerce Bank, based in New Jersey, calls itself “America's most convenient bank”; HSBC claims to be “the world's local bank”.

Much of this survey will explore this change in banking fashion. The reasons for it are partly cyclical. Retail banking is less subject to the ups and downs of the business cycle than wholesale or investment banking. So it is no surprise that during America's recent economic downturn and subsequent recovery banks with a strong retail business did well, especially when low interest rates gave a huge boost to mortgage refinancing and consumer borrowing. The profitability of retail has in turn encouraged banks to invest more in their retail operations.

The cycle may now be turning. Mortgage business slowed towards the end of last year, and commercial and industrial lending are looking brighter. Underwriting and mergers also seem to be picking up. Some banks may have overdone the rush to build branches. Even so, the past few years have reminded banks that retail is less risky than the more glamorous bits of banking.

So some recent converts may pay more attention to retail in future too. J.P. Morgan Chase cast its acquisition of Bank One, announced in January, as a portfolio decision. Bank One increases the weight of retail banking in J.P. Morgan's mix. “Given our starting point, given our aspirations, our portfolio is somewhat unbalanced,” explains David Coulter, J.P. Morgan's head of investment banking. Those who have been concentrating on retail for many years need no persuading. “It's where two-thirds of the money is,” says Richard Kovacevich, chief executive of Wells Fargo.

It also seems reasonable for banks to bet on steady growth in retail finance. According to John Drzik of Mercer Oliver Wyman, a consulting firm, there are two good reasons why the financial-services industry worldwide can be expected to grow faster than GDP. First, the proportion of income spent on financial

services rises with income. People put more money in the bank. They spend more on insurance and on investment products. And they are willing to borrow more, boosting the demand for consumer credit.

Second, market liberalisation helps the industry. In freer economies such as America, Australia and Britain, Mr Drzik reckons, financial services account for perhaps 8-10% of GDP. In continental Europe, their share is maybe 4-6%. In Asia, Tab Bowers, of McKinsey's Tokyo office, expects that markets in personal financial services will grow by $180 billion between 2001 and 2010. That is equivalent to the rise in America's market between 1994 and 2001.

Already the past couple of years have been kind to banks in many countries. America's banks, jittery in the previous downturn, came through the recession of 2001 all but unscathed and saw profits surge last year. In Britain, where the economy has been bonny, banks made so much profit last year that they earned brickbats not plaudits from the press.

Even the world's laggards have something to smile about: in Japan, there are signs that the country's banking system is beginning to mend after a dozen awful years, and in Germany there is also evidence of improvement. China's authorities have made a start on dealing with the gargantuan bad debts of the country's four biggest banks.

Broadly speaking, banks that supply financial services efficiently are likely to be healthier than those that do not. It is no accident that America and Britain, where banks have been largely free to go about their business, have had sounder banking systems than Japan, in which bank lending was influenced by the state, or Germany, where the public sector looms large.

Lubricating capitalism

However, banking is not just another industry. Banks have a special economic function, recycling capital from savers to borrowers. The health and profitability of banks matters not only to their shareholders but to just about everybody else too. If banks foul up on the allocation of capital, the results can be catastrophic. If a big bank fails, the whole economy can seize up. That is why banks are regulated differently from other businesses. In particular, they are expected to maintain minimum capital standards, set out in an international agreement, the Basel accord.

Nevertheless, even in recent years banks and their supervisors have sometimes got things badly wrong. In the past decade, there have been banking crises in Argentina, East Asia, Japan and the Nordic countries; and in the 1980s and early 1990s, the savings-and-loan crisis helped to bring down hundreds of American banks. Supervisors are now revising the Basel accord in an effort to make banks and economies safer. But they have their work cut out, as the next article will show.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Bothersome Basel

Apr 15th 2004
From The Economist print edition

The new capital-adequacy rules have proved tricky to draw up

BANKS might imagine themselves to be the financial equivalents of Wal-Mart. Their regulators, however, are unlikely to be persuaded that they are watching over nothing more complicated than big shops. In most industries, companies are, or should be, allowed to go under if they become insolvent. Up to a point, the same goes for banks. Yet bank supervisors go to special lengths, and draw up special rules, to ensure that their charges have sufficient capital to keep them out of difficulty. These rules are due to change at the end of 2006. The changes are detailed, possibly far-reaching and certainly controversial. “It's the elephant in the room,” says Andrew Kuritzkes of Mercer Oliver Wyman.

Left to take its course, the failure of a big bank can wreak economic havoc. Its depositors lose their money. The bank cannot meet obligations to other banks, which may fail in turn, ruining their depositors. The depositors of failed banks are likely to have creditors of their own, who will also suffer financially. In fact, the mere fear that a bank may be in danger of failing could be enough to spark a run, which would then spread to other banks. Most governments underwrite bank deposits, up to a limit, so that depositors have no need to panic should banks look wobbly. In the United States, the Federal Deposit Insurance Corporation (FDIC) guarantees that savers at insured institutions will get at least their first $100,000 back.

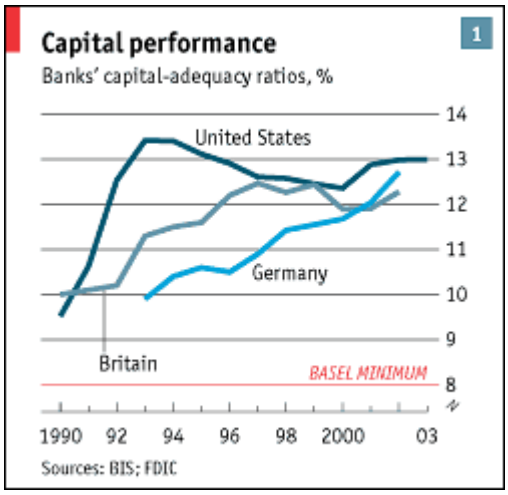
The trouble is that this creates a moral hazard for banks. Knowing that the state will bail out depositors, they might take more risks than they would if deposits were not guaranteed. Some banks, moreover, are thought to be “too big to fail”. All this helps to explain why banks are subject to special regulations. They may be banned from doing things that regulators consider too risky, such as owning shares. Bail-outs may be conditional on the managers being sacked. The most important rules, however, are those setting minimum capital requirements.

The current rules, known as the Basel accord or Basel 1, were drawn up in 1988 and implemented in 1992. They require a bank's capital to be at least 8% of its risk-weighted assets. The weight for each class of asset ranges from zero (for assets thought to be very safe, such as the government debt of developed countries) to 100% (for unsecured loans to consumers and companies). In practice, the rules vary slightly across countries: in Japan, for example, shares in other firms can be counted as capital, and the minimum capital ratio for banks that are not internationally active is only 4%.

The plan is to replace this accord with a new one, Basel 2. During the 1990s, big banks' risk-management systems became far more sophisticated than required under Basel 1. Moreover, Basel 1 had an unintended consequence: its weights did not match the market assessment of the risks that banks

faced. So banks indulged in “regulatory arbitrage”: they disposed of risks for which Basel 1 required more capital than the market did, such as credit-card debt or residential mortgages; and they retained assets for which the market demanded more capital than the regulators did. The rise in banks' capital-adequacy ratios (see chart 1) thus reflects regulatory arbitrage as well as better risk management. The ratios therefore mean less than supervisors would like.

Basel 2 is intended to bring regulatory capital requirements more into line with actual risk and to reflect improvements in the best banks' practices. The broad outline has been clear for some time, and almost all the details have now also been sorted out. The new set-up will have three “pillars”. Pillar 1 requires banks' capital to be at least 8% of risk-weighted assets, the same as now: the weighting system, however, will change. Pillar 2 says that banks must plump up their capital cushions if national supervisors consider them too thin, even if they are above the minimum. Pillar 3 stresses the importance of market discipline, and says that banks should become more open about risks to their capital positions and profitability. This has already had an effect. In 1999, most big American banks kept mum about such risks in their annual reports; by 2001, the proportion was down to one quarter.



Three pillars of wisdom

Pillar 1 breaks up regulatory capital into three parts, to match credit risk, market risk and operational risk. The market-risk element, dealing with trading losses, is unchanged from Basel 1 (which was amended for this purpose in 1997). The operational-risk part is new: it says that banks' capital should reflect the risk of mistakes and wrongdoing. An example might be a fine levied on a bank for overcharging credit-card customers.

For measuring credit risk, banks will have three options, each of which will assign more detailed weights to their assets than Basel 1 did. Under the simplest “standardised” approach banks will use external data, from credit-rating agencies and others. There are also two methods based on banks' own internal ratings. The more sophisticated of these is known as A-IRB.

All this requires a lot of data to be collected and processed, on which banks have already started. You need several years' worth of statistics to be able to assess the likelihood that the ball-bearing company to which you lent $500,000 will default next year, especially if you are allowing for the swing of the business cycle. The cost of compliance is correspondingly high. Mr Kuritzkes reckons it will be 0.05% of assets—or $100m-200m for a big bank—over the next few years.

For many activities, and thus for a fair few banks, the new regime implies big changes in capital requirements. The new operational-risk element, for instance, will hit banks specialising in areas—such as custody or asset management—that involve little lending and therefore in the past have needed little capital to keep supervisors sweet. In the credit-risk area, the weight attached to mortgages looks likely to drop by 30-50%, cutting the minimum capital requirements of banks specialising in home loans. Almost any bank with a lot of retail business—except for sub-prime lending and perhaps credit cards—can expect its minimum capital to fall.

However, working out the precise effects of Basel 2 is difficult. First, the rules are complicated and not quite complete. The main piece of outstanding business is the weight attached to lending on credit cards. In their accounts, banks include “expected losses” in operating costs. This is their best estimate, from past experience, of credit-card debts that will not be repaid. Because they have counted this as a cost, they say that minimum capital requirements should be calculated on the basis of credit-card assets net of expected losses. Originally, regulators disagreed, saying that expected losses should be counted in the asset base. Banks persuaded them to change their minds late last year. Now the formulas are being worked out again.

Second, the majority of banks, at least in America and Europe, are comfortably capitalised according to Basel 1. A change in their capital requirements might therefore make no difference: if they are not capital-constrained, their minimum could go up or down without changing their behaviour. Third, even if a bank's minimum requirements under pillar 1 go down, under pillar 2 its supervisors could still add to the minimum. Fourth, financial markets might frown on a bank that reduced its capital ratio, so even if

Basel 2 relaxes its capital constraints, the market might not.

Most banks that will have to implement Basel 2 seem content with it, or at least resigned to it. Most of them, and their regulators, expect it to come into effect more or less on time—where, that is, it is being introduced. Every bank in the European Union, down to the last *Sparkasse*, will have to comply with Basel 2. In fact, many European banks think that new accounting standards, due to be adopted by all listed companies in the EU by next year, are just as big a worry. The proposed treatment of derivatives, in particular, could cause big swings in their accounts.

In America, only a few big banks will be required to switch to Basel 2. The Americans propose that only "big, complex, banking organisations" will have to adopt the new rules. In essence, this means the top dozen or so banks; however, other banks are free to switch if they want to, and regulators expect that a total of 20 or so will do so. America's Basel 2 banks, however, will be obliged to use A-IRB, the most advanced method of assessing credit risk. They will also have to employ the most sophisticated of the three ways of measuring operational risk.

Not everyone in the United States is happy about this. Mr Kovacevich at Wells Fargo, which will have to change over, does not see why it should: "We're large, but we're not complex. There are banks smaller than us and not in Basel 2 that are complex. We're not internationally active...I don't think that they have any right or credibility to say how we should manage our credit risk." The change will cost tens of millions of dollars, he complains, and regulators might not allow him to keep the "effective" risk-assessment system he already has. Indeed, "it might make us less effective." Wells Fargo's main competitors, he says, are small enough not to have to adopt the new system.

Small banks, and the politicians who speak for them in Congress, take the opposite view: that Basel 2 will benefit big banks at their expense. More generally, it is possible that having two sets of capital-adequacy rules will distort competition between Basel 1 and Basel 2 banks. Because of the complexity of the regulations and of America's banking markets, it is hard to tell from first principles whether it will or not. So economists at the Federal Reserve have been studying four areas of possible distortion: lending to small and medium-sized companies (SMEs); mergers; the mortgage market; and credit cards.

The first two studies were published in early March. In the SME market, the worry is that small, community banks might lose out because bigger banks that had adopted Basel 2 would have lower capital requirements and therefore would be able to lend at lower rates. This looks unlikely, finds Allen Berger, the author of the SME study. Community banks have an advantage in serving "opaque" SMEs, which publish little information but whose bankers know them intimately. Big banks' extra edge on interest rates—at most 16 basis points—would probably not overturn this. More at risk might be the bigger Basel 1 banks, which compete with larger institutions to serve bigger, more "transparent" SMEs.

Some have also argued that the dual system of regulation will increase the consolidation of America's banking system. Broadly, Basel 2 banks are likely to have lower minimum capital requirements than Basel 1 banks. They will therefore have an incentive to buy Basel 1 banks in order to free the extra capital that these institutions have to put aside. The Fed's study of this question finds little convincing evidence to support this. Past changes in regulatory capital or capital standards have had little significant effect on merger activity.

Regulatory competition

However, there are other unresolved doubts about Basel 2. Officials at the FDIC point out that American banks are subject not only to Basel rules but also to domestic "prompt corrective action" (PCA) requirements. These were introduced to strengthen the banking system in the early 1990s. To be called "well-capitalised", a bank must have tier-one capital of at least 5% of its unweighted assets; below 4%, it is considered undercapitalised. The FDIC estimates that Basel 2 banks can expect their capital requirements to fall sharply—maybe by 30% on average over a business cycle. This is enough, says the FDIC, to drag the Basel 2 minimum below the level needed to keep equity ratios above 4% for most of a typical economic cycle. So regulators will have to choose between weakening the PCA framework that has served America well, and ignoring the implications of Basel 2.

Swing lower

Another concern is that Basel 2 might make business cycles more severe, by causing banks to tighten credit too much during recessions and loosening it too much during booms. In a recent paper, Anil Kashyap, of the University of Chicago Graduate School of Business, and Jeremy Stein, of Harvard University, argue that this criticism is well founded.

In essence, the Basel 2 rules convert the probability that a borrower will default, the size and maturity of the loan and a bank's exposure at default into a capital charge. The higher the probability of default, other things being equal, the higher the charge. Thus banks must assign higher charges to riskier borrowers. And if recession increases everyone's chances of default, then capital charges rise across the board. To reduce the riskiness of their portfolios and to hold down the probability of default, banks will tighten their lending conditions. The danger is that this will make the recession worse.

In an ideal world, say Mr Kashyap and Mr Stein, capital charges would not vary as much across the cycle as across borrowers. The charge is, in effect, the price of capital to the bank: it should therefore reflect the scarcity of capital relative to the demand for it. In recessions, because bank capital becomes more scarce relative to lending opportunities, it makes sense to accept that during recessions the probability of default will rise.

Mr Kashyap and Mr Stein have estimated what the effects on minimum capital requirements might have been had Basel 2 been in force between December 1998 and December 2002, when there were marked economic slowdowns in both America and Europe. Using default probabilities calculated for some 17,000 firms by Moody's KMV, a credit-risk analysis firm, they estimate that minimum capital charges would have risen by an average of 36% over the four years. Under Basel 1, charges would have gone up by 22% in any case, making Basel 2's contribution 14%. For investment-grade borrowers, the effect is stronger: a 111% increase in capital requirements, of which 82 points are attributable to Basel 2. The impact on junk-rated firms is much smaller, presumably because their initial capital charge and thus the implied probability of default at the outset is high. When conditions tighten, many of them default (and thus drop out of the sample); for those that survive, there is not much room for their charges to rise.

These estimates cover only minimum requirements, and most banks will have much more capital than they need, so the effect of recessions on actual capital might be much less dramatic. A lot might rest on pillar 2 of the new accord—ie, on whether supervisors allow banks to lose a bit of padding during recessions. A lot depends also on the timespan over which default probabilities are estimated: longer periods of calculation would make capital requirements less sensitive to business cycles. Mr Kashyap and Mr Stein found the effects were somewhat smaller when they used default probabilities based on Standard & Poor's credit ratings, which change less over a cycle than those of Moody's KMV.

So there is still much to argue about before Basel 2 comes into effect. Despite regulators' attempts to deal with the objections, such a complicated set of rules is almost sure to throw up unintended consequences that no one has yet spotted. “Certainly this is not going to eliminate regulatory arbitrage,” predicts Mr Kuritzkes. Basel 1, he says was “more humble”, as regulators tried to establish good principles. Basel 2 is a much grander, and perhaps riskier, endeavour.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Just deserts?

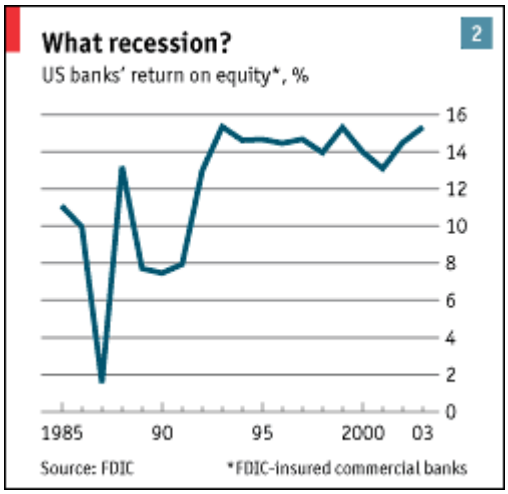
Apr 15th 2004
From The Economist print edition

Scandals aside, most of America's banks have thrived on cheap money and, yes, good management

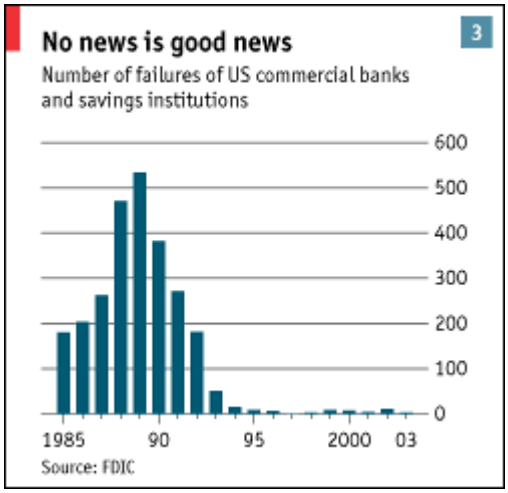
ST PAUL may have been wrong about sin: sometimes it pays. In the first few weeks of this year, America's banks revealed record profits for 2003, $120 billion in all. The biggest of them, Citigroup, clocked up $17.9 billion, the most ever made by a single bank. Yet in the eyes of many Americans, financial institutions do not begin to deserve their good fortune.

In the past year or two, scandal has touched just about every corner of America's financial industry. Last year Wall Street firms (including Citigroup and J.P. Morgan Chase, as well as pure investment banks) paid a total of $1.4 billion in fines and compensation for failing to deal with conflicts of interest between research and securities underwriting during the tech-stock boom. Bank of America and FleetBoston Financial recently agreed to pay $675m in penalties and fee cuts to settle allegations of wrongdoing in trading mutual funds. Banks' reputations have also been stained by the corporate scandals at Enron, WorldCom and Parmalat.

Last year banks were buoyed by America's consumer-led, debt-fuelled economic recovery. Before that, however, they had to cope with more than blots on their character. America tumbled into recession in 2001, and that year's terrorist attacks on New York and Washington, DC, might have been expected to inflict great damage on the economy and the financial industry, on top of their terrible human cost. Yet America's banks have not only survived all these blows: they have thrived.



The last time the American economy was in difficulty, in the early 1990s, the financial industry was badly bruised. Between 1989 and 1993, supervisors closed 1,418 banks with assets of $554 billion. Citibank, Citigroup's predecessor, was thought to be at risk of going under. This time, the industry has suffered barely a scratch. Profitability stayed high even when the economy stumbled (see chart 2), and in the past six years only 36 of America's 9,000 banks and savings institutions have failed (chart 3). Why have most of them escaped trouble?

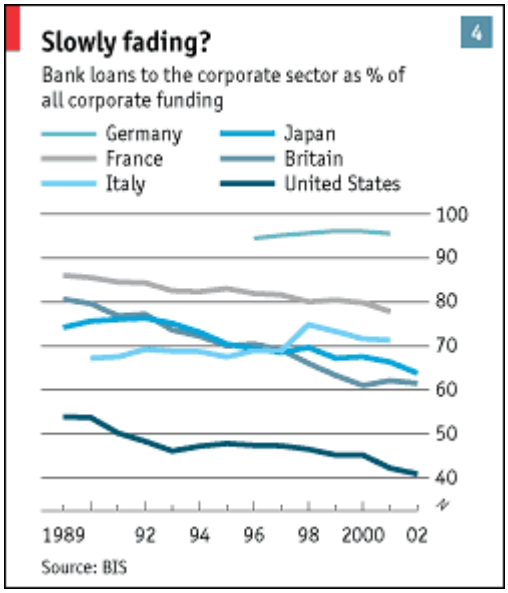


One reason is that the 2001 recession was much less deep than that of a decade before. Even allowing for this, however, banks have become more resilient. These days they are a much less important source of corporate finance than they used to be, so they are less exposed to a downturn in the economy. In America, banks now directly supply only about 40% of the money that companies raise each year, compared with 50% a decade ago, and far more in other countries (see chart 4).

Bigger companies are increasingly likely to tap the capital markets, which are far deeper in the United States than in Europe or Asia. When such companies get into trouble, the main sufferers are bondholders rather than banks. Granted, banks are not immune to weak capital markets: most big banks have investment-banking arms, which miss out on underwriting fees when companies raise less money. But at least the pain is shared with specialist securities firms.

Despite the increased importance of capital markets, even in America bank loans are still the biggest single source of corporate finance. Much of American banks' recent success is due to their increased deftness at managing this basic function of transferring capital from savers to borrowers. Naturally, defaults by corporate borrowers increased when the economy turned down: the rate of written-off loans more than tripled between 1999 and 2002. However, figures from the Federal Reserve show that large banks began tightening their credit standards and imposing more stringent terms well before recession set in.

As well as improving their reading of the economic tea-leaves, banks have become adept at diffusing the risk of their loans. “There has been a step change in risk management,” says Doug Woodham of Moody's KMV. But mainly in America and western Europe, he adds: elsewhere, especially in Asia, banks have been slower to adopt new credit-risk technology.



The growth over the past decade of markets for spreading risk among institutions has been remarkable. Most mortgages, for example, are securitised, taking them off the books of the originating banks. In the syndicated-loan market, in which one bank (or a small group) brings together a large number of lenders, which might include pension funds and insurers as well as other banks, about $2 trillion was committed in 2001, more than twice the amount in the early 1990s. The value of loans sold to other financial institutions on the “secondary” market grew fivefold in the 1990s, to about $100 billion.

The most dramatic development, however, has been the rise of credit derivatives, especially credit-default swaps (insurance against the risk of default), which have been bought overwhelmingly by big banks. In the third quarter of last year, American banks held more than $400 billion-worth of credit-default insurance; on the other side, they were guarantors of almost $350 billion-worth. Until the mid-1990s, this market barely existed.

The effect of all this has been to soften the effect of corporate defaults on America's banking system. When companies defaulted on their bonds, or when bond prices were marked sharply downwards, it was all bondholders who suffered, meaning hedge funds, pension funds and insurers as well as banks. When companies defaulted on loans, the costs were spread through syndicates or passed on to the sellers of credit-default swaps, not dumped on the lending banks. The existence of the credit-default swap market may have helped to increase the supply of corporate loans: banks are more willing to lend if they know that they can buy insurance against default.

A bigger cushion

Changes in regulation and legislation have also left banks with thicker cushions against economic bumps. The repeal of laws restricting banks' movement across state borders has allowed them to cover bigger areas, so they are less exposed to local economic problems.

Increased profitability and tougher supervision have helped too. The Basel accord has been one factor. American banks' capital is now 13% of risk-weighted assets, up from 10% in 1990. The Basel minimum is 8%. Domestic regulations added, among other things, requirements for the banks' equity-to-assets ratio: if this falls too far, the FDIC, which insures bank deposits, must step in.

For America's banks this is all fine, but for other parts of the financial system it will mean additional costs. Banks have improved their risk management partly by passing credit and market risks on to other parts of the financial system, such as other banks, insurers, pension funds and hedge funds. These recipients have been perfectly happy to accept those risks, and many of them even understood what they were doing. Financial regulators, however, worry that they can no longer see where risks end up. Watching out for financial crises has therefore become a much less exact affair than it was: supervisors now have to keep an eye on sellers of credit insurance as well as on the original lenders.

When the tech-stock bubble burst and America's economy turned down, no one really knew what had happened to the risks that would once have been borne mainly by banks. The best guess is that the pain was spread broadly across the financial system, with no single big institution bearing a dangerously large

share of the burden. Good: that is what derivatives are supposed to do. Another time, however, will the system work as satisfactorily?

The improved resilience of America's banks has probably helped the economy. If more of them had closed or had to call in loans to shore up their capital positions, America's GDP would surely have been weaker. Countries such as Japan and Germany, where companies depend much more heavily on bank finance and capital markets are less well developed, have suffered as faltering economies and banks have dragged each other down.

With a little help from the Fed

However, American banks cannot take all the credit for their own health. Twice in the past ten years they have had a strong helping hand from the Federal Reserve. Sharp cuts in short-term interest rates in the early 1990s allowed them to rebuild their lending margins; and in the past few years, the Fed has again kept money cheap. The effect of this on America's banks is plain, says Stephen Kealhofer, a founder of Moody's KMV. When the Fed began to cut rates sharply in the summer of 2000, the market values of American banks rose. This sharply reduced their debt-default probabilities. Banks in other countries were not so lucky.

Cheap money set off a boom in personal borrowing, especially against homes. Householders jumped at the chance to remortgage—indeed, to increase their debts—helped by America's system of allowing homeowners to redeem their long-term fixed-rate loans early without penalty. Even though mortgage lending slowed in the second half of 2003, households' mortgage debt in the last quarter of the year was $6.8 trillion, 27% up on two years earlier. The recent fall in bond yields may give mortgages a new boost.

The boom in mortgages and consumer credit has meant a bonanza for banks catering mainly for retail customers. In 2001, for example, those among America's 50 biggest banks that earned most of their profits from lending on residential property and consumer banking showed markedly higher returns on equity than others: on average, they beat the rest by three percentage points.

In a sense, this is what the Fed is for. Monetary authorities are supposed to cut interest rates when economies wobble. At one point it seemed possible that America might lurch into deflation. The Fed said the risk was remote, but it was understandably keen to avoid the fate of Japan after that country's bubble burst in 1990. Many Europeans wish that the European Central Bank had been equally ready to ease monetary policy.

Cheap money has been helpful to America's banks but, unhelpfully, it has also increased the economy's already giddying macroeconomic imbalances. Last year American households borrowed $880 billion, or 8.1% of GDP. The government borrowed more than $500 billion and business another $278 billion. All this was financed by record lending by American banks, to the tune of more than $1 trillion, and a record current-account deficit of more than $500 billion. In effect, the Fed has invited American householders to join the government in borrowing and spending all they can: foreigners have lapped up government debt, and consumers have been fed cash by the banks.

What if interest rates rise, as they surely will at some point? The great borrowing binge could end in tears. Some (including this newspaper) see a property-price bubble bursting in certain cities. Even if that does not come to pass, credit quality has undoubtedly declined.

Cheap money has enabled many people on low or variable incomes to buy homes for the first time, pushing home ownership in America to a record high. Although most American mortgage borrowers have fixed-rate loans, many new buyers have bought their homes on variable-rate mortgages. These borrowers are vulnerable to rising interest rates. Moreover, interest rates on home equity lines of credit (on which borrowers can draw up to a level based on the equity they have in their homes) are by and large variable. Since early 2000 these credit lines have increased by 140%, to more than $250 billion.

Banks may find consumer business more difficult if rates rise. Marginal borrowers may struggle to pay debts. Rising bond yields have already dampened mortgage business, and rising short rates may make it harder to attract the deposits for which many of the banks have been scrambling, because other investments (certificates of deposit, say, or shares) may become more attractive.

Granted, rising rates often go with a rising economy. The corporate business that turned down along with

the economy should soon pick up. Meanwhile many banks, having invested so much in retail banking in the past few years, will still expect to make money. And even if the cycle turns against them, they can comfort themselves with the prospect that Americans will keep getting richer, so will save more and want to keep borrowing.

One way for the banks to prepare for that happy prospect is to increase their (thus far limited) geographical reach, as the next article will show.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Bigger footprints

Apr 15th 2004
From The Economist print edition

Banking is becoming a less local business

EVEN bankers notice eight-figure price tags. Most of them thought that Bank of America (BofA), America's third-biggest bank, was being extravagant last October when it agreed to pay $47 billion in shares, 40% above the market price, for FleetBoston Financial, the ninth-biggest and the market leader in New England. Yet the amount was not the only eye-catching aspect of the deal. In snaffling FleetBoston, BofA is due to become America's closest thing to a nationwide bank. It already had branches in 21 states plus Washington, DC, and on both coasts. New England was the last big gap.

The deal was a reminder that in the United States banking, at least at the retail level, is still a local rather than a national industry: not even BofA will have branches in every state. Much the same is true in Japan, with its 120 regional banks and 300-odd credit unions. In the European Union, an economy of comparable size to America's, the story has a different twist: although there is not much more room for national consolidation, except in Germany and perhaps Italy, there have been few cross-border mergers or other steps towards a single banking market.

Clearly, large parts of the financial industry—notably those catering to the financing needs of big companies—are truly international. A handful of firms (mainly American, plus two Swiss and one German) hold sway over most of investment banking. According to the Bank for International Settlements, the share of the five biggest banks in international bond underwriting, arrangements of syndicated loans and derivatives is over 40%; in international equity issuance, over 50%.

In retail financial services, too, some businesses are becoming global. British householders are inundated with fliers from American credit-card companies such as MBNA and Capital One. Barclaycard, the credit-card arm of Britain's Barclays bank, has added Ireland and Portugal to the list of countries where it operates. A handful of global banks have retail businesses in several countries. Citigroup is the prime example, with operations in 54 countries. HSBC is another: besides being strong in Britain and Asia, it has a subsidiary in France and is the fourth-biggest deposit-taker in New York.

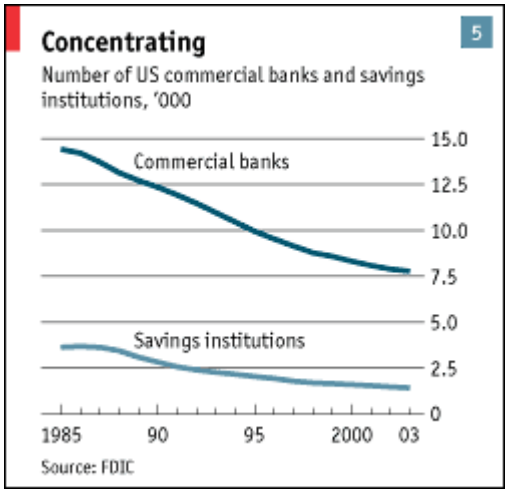
America's banking industry has been becoming less local for several years. During the 1980s and 1990s, mergers created banks with larger regional retail “footprints”: BofA, FleetBoston and Bank One are all products of such transactions. In the past ten years, the number of banks has fallen from about 11,000 to around 8,000, thanks in large part to the Riegle-Neal act of 1994, which made it easier for banks to break out of their old confines.

Before Riegle-Neal, banks in one state were not allowed to open branches in another; interstate banking was permitted, but only through holding companies with separate subsidiaries for each state. Riegle-Neal lifted the ban on interstate branching, which encouraged not only mergers but also the reorganisation of holding-company structures. Tara Rice, an economist at the Federal Reserve Bank of Chicago, has identified 4,657 mergers and 4,626 cases of internal consolidation in America between 1994 and June 1999.

Consolidation still has some way to go, but the pace has slowed since the mid-1990s. Last year, according to the FDIC, the number of banks and thrifts fell by 172, perhaps one-third of the decline eight or nine years ago. Banks are founded all the time: 119 new charters were granted last year, whereas 275 banks were swallowed in mergers. In the western states watched over by the Federal Reserve Bank of San Francisco, 14% of banks are less than three years old; 23% are under five.

It is possible that BofA's purchase of FleetBoston and J.P. Morgan

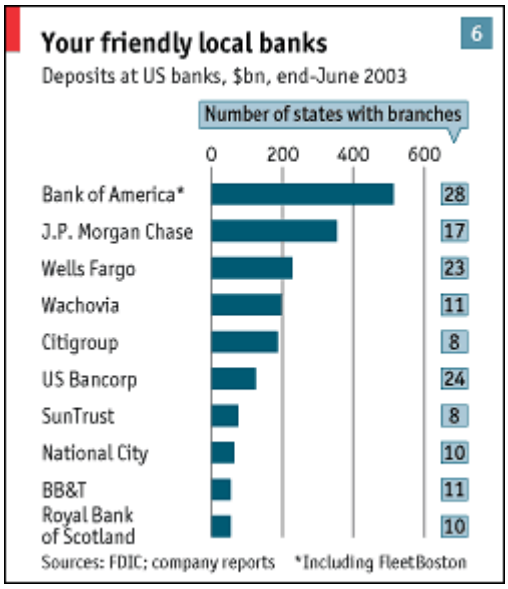
Chase's $58 billion acquisition of Bank One, announced in January, will bring on a new surge of deals, with the biggest banks chasing national footprints instead of merely regional ones. Some analysts think that the second tier of banks will want to close the gap that has opened between Citigroup, J.P. Morgan Chase, BofA and the rest. And geography is not the only reason for banks to buy each other. J.P. Morgan Chase wanted to get its hands on Bank One's credit-card portfolio, America's fourth-biggest, as well as its mid-western branches. “Organically it would have been difficult to build the card share that we'd get from this merger,” says Mr Coulter.



In contrast to the national picture, at a local level the industry is already fairly concentrated. Even after the two big mergers, the top ten banks' combined share of national deposits will be only 36%, thanks to the legacy of local banking and to a cap of 10% on the share of any one bank. In individual cities, however, it is common for the top five banks to command 70% of deposits. Viewed in this way, says David Golden of Mercer Oliver Wyman, America is much more like Europe than the national picture suggests.

The high degree of concentration in local banking markets, says Mr Golden, means that for most banks mergers are the easiest route to growth. “Organic growth in a highly consolidated market is more difficult. It's easier to buy a powerful incumbent, even at a premium.” He suggests that this makes the achievements of banks such as Washington Mutual and Commerce Bank, which have broken into new markets by opening branches by the dozen, all the more impressive.

Europe too has seen a wave of consolidation, but this has mainly been on national lines. There was a rash of big domestic deals between 1999 and 2001: in Germany, Allianz, a huge insurer, bought Dresdner Bank; in Britain, Royal Bank of Scotland bought NatWest, and Halifax teamed up with Bank of Scotland to form HBOS; and in France, BNP and Paribas joined forces. Since then, except for one more French deal, between Crédit Agricole and Crédit Lyonnais, little has shifted. In many countries, consolidation is close to its limits. An attempt by Lloyds TSB, one of Britain's largest banks, to buy Abbey National (now Abbey), the country's number six, fell foul of the competition authorities in 2001.



Cross-border deals in western Europe have been few and far between. The main exceptions have been the creation of Fortis, a Dutch-Belgian bancassurer; the fusion of a Finnish, a Norwegian and a Swedish bank; and the purchase by Germany's HVB of Bank Austria. (In order to raise cash, HVB has since floated 25% of its Austrian subsidiary.) In central and eastern Europe, by contrast, westerners have been eager buyers. Some 60% of the region's banking assets are in foreign hands.

There is little sign that the pace of change in Europe is suddenly about to pick up. A recent report by analysts at Fox-Pitt, Kelton, an investment bank, ran the rule over 18 conceivable mergers or takeovers involving European banks. Of the few that the analysts concluded were worthwhile, only one was a cross-border deal (a purchase by Denmark's Danske Bank of a Swedish institution).

Don't rush in

The Fox-Pitt, Kelton team suggests several reasons why a big cross-border deal is unlikely in the near future. Compared with what acquiring banks would have to pay, the scope for cost savings is limited: products, regulations and taxes still differ enormously from one European country to the next. The managers of possible target banks that have survived the economic downturn are unlikely to want to cede control now. Cultural differences between European countries remain marked, and political opposition to foreign takeovers is still fierce. Lastly, banks are uncertain about future regulation and might therefore adopt strict capital standards as a precaution, at the expense of efficiency.

In both America and Europe, most cross-border deals for now are selective forays rather than big

mergers between leading banks. Last year HSBC bought Household, an American sub-prime consumer lender. HSBC's muscle brought down Household's funding costs at a stroke. Conversely, Household gave HSBC an entrée into the American consumer-finance market—and contributed $1.8 billion to its pre-tax profit last year. Another big British bank, Royal Bank of Scotland, has a foothold in American retail banking through Citizens Bank, the biggest bank in New England after FleetBoston.

Some bankers think—or hope, or fear—that the latest big takeovers in the United States will trigger change in Europe. John Varley, chief executive-designate of Barclays, has described them as a “wake-up call” for banks elsewhere. By the time Europeans get around to merging with each other, some worry, the Americans will be a long way ahead—and will be big enough to buy any European bank they choose.

They have already had a look. Before BofA bought FleetBoston, there were rumours that it was talking to Barclays. Citigroup is thought to have had talks with Deutsche Bank. Although Citi has said it is not seeking any more “transformative” mergers, it is known to be interested in foreign acquisitions. And many deals that would cause a splash in Europe would not be big enough to “transform” Citi: its market capitalisation is five times that of Deutsche, Germany's biggest bank.

The idea of Citi and Deutsche getting together made some sense. Citi has already shown that it can make money in German retail banking; Deutsche, having struggled in this market, may now be getting its act together. Deutsche has Germany's biggest asset manager and perhaps the country's fattest book of corporate contacts. But there were also good reasons to hold back. Merging two investment-banking teams (or ditching one) would be hard—it once scuppered a takeover bid by Deutsche for Dresdner. And Deutsche's chief executive, Josef Ackermann, has been on trial, accused of a breach of trust in awarding huge bonuses to top managers after the controversial takeover by Vodafone of Mannesmann.

The Citi-Deutsche deal fell, it is said, because it was likely to run into political opposition. Sooner or later, though, someone will concoct a deal in which the financial benefits outweigh the political obstacles. The big question is whether the Europeans will cut such a deal for themselves, or let the Americans do it for them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

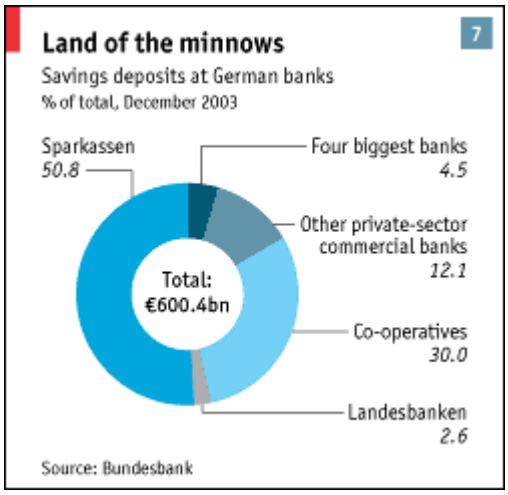
Cracks in the pillars

Apr 15th 2004
From The Economist print edition

Germany's banking market is showing signs of movement

CARICATURES may exaggerate, but they contain a lot of truth. So it is with the well-worn picture of Germany's banking market: too many banks making too little money.

In all, Germany has more than 2,200 credit institutions, 30% of the European Union's total. And it has already got rid of a fair few: as recently as 1997 it had nearly 3,600. Britain, despite London's importance as a financial centre, has only 420. Germany's five biggest banks account for just 20% of total assets in that country, compared with 80% or so in Belgium, Finland and the Netherlands. Germany has about 60 bank branches for every 100,000 people; Britain, Finland, Ireland and Sweden have at most 25.



The German banking system has three “pillars”. Private-sector banks are in a minority, whether measured by number or by market share. The four biggest—Deutsche Bank, HVB Group, Dresdner Bank (owned by Allianz, the country's biggest insurance company) and Commerzbank—may be well known outside Germany, but in their home market they are minnows, with just 4.5% of savings deposits.

The biggest share of the market, about half, is held by 500-odd *Sparkassen*, or savings banks. Most of these are owned by municipalities. There are 11 *Landesbanken*, wholesale banks owned by savings-banks associations and state governments; some *Landesbanken* also have stakes in others. The state also owns a majority of the post office, which has a banking subsidiary. The third pillar consists of the 1,400 co-operative banks, such as Mr Vogt's in Gammesfeld, which have 30% of retail deposits.

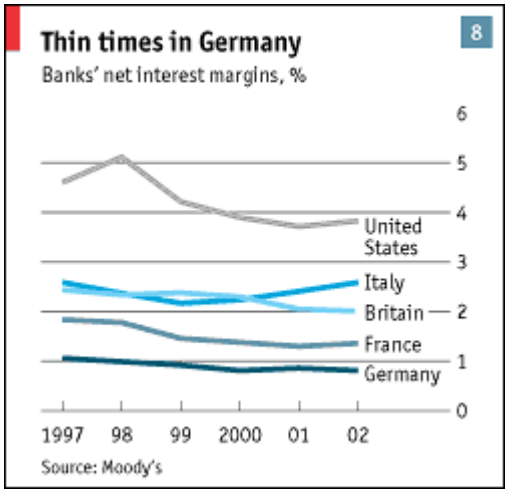
In such a crowded field, private-sector banks have found it difficult to make money from domestic banking. The only one to have had much success, Deutsche, got most of its profits from its global investment-banking business. In part, these banks' difficulties stem from their public-sector rivals' ability to draw on state guarantees—which, however, are due to be phased out from July 2005. For the co-ops, the pursuit of profit is not a priority, so they, too, are hard to compete with. The grim state of the German economy, which shrank last year and has not grown much in the past decade, has made matters worse, especially on the corporate side. Small wonder that German banks' interest margins are easily the lowest in Europe (see chart 8).

The private-sector banks have long complained about unfair competition from the state sector. They have a point. But their own shortcomings have also been to blame. It is possible for such banks to make money in Germany. Citigroup, which has some 300 Citibank branches in the country, manages it. In 1973 it bought KKB, a downmarket consumer-finance specialist—the sort of place, says one banker, you would go to if you couldn't get a loan elsewhere—and turned it into an efficient consumer bank.

Citi did a fine job of stripping out the high costs that bedevil so many of its rivals. It centralised back-office functions. Unlike most German banks, it has a single sort code for its accounts instead of one per branch, and most calls to branches are re-routed to a call centre. It was quick to introduce machines to read the money-

transfer forms which Germans still use to pay most bills. All this freed staff from routine tasks to focus on advising customers. Citi's cost-income ratio, a common measure of a bank's efficiency, is only 43%, about half that of other private-sector banks.

Some bankers are sniffy about what Citi has achieved, arguing that its performance reflects its narrow focus. The big private-sector banks, they think, have to offer their customers something broader and grander. But so far they have failed to do that. Klaus-Peter Müller, chief executive of Commerzbank, is more even-handed than most. “It's not a question of Citibank,” he says, “it's a question of KKB. Citibank didn't invent the wheel. They bought the wheel and they've used it.”



Slow off the mark

Besides missing this trick, German banks have often let non-banks take business that they might have had themselves. “They are not considering anyone who's not a financial institution as a competitor,” says Holger Kern of Monitor Group, a consulting firm. One of the fastest-growing banks in Germany, he points out, is the consumer-finance arm of Volkswagen. It has just struck a deal with the ADAC, a motoring organisation with 15m members, to offer car loans. Tchibo, a coffee retailer that also sells clothes and household goods, is moving into financial services too.

The state-banks issue, says one German banker, “is also sometimes an excuse for doing nothing.” But recently his peers have become more willing to face up to their institutions' weaknesses. First, they have become much less prone to underpricing risks and more willing to cut borrowers off, despite protests from customers and business associations. The obligations of Basel 2, which will force banks to align capital more closely with risk, has been useful in this respect. More generally, their relationships with corporate clients have become harder-edged.

Second, the private-sector banks have tackled their bad debts and discarded weak businesses. Allianz put Dresdner's rotten debts (including an unsavoury lot from Latin America), as well as loans from discontinued overseas operations, into a semi-separate “bad bank”, to be sold, repaired or written off. HVB has sold much of its property portfolio, trumpeted only a few years ago as a core part of its business.

Third, they have cut costs, closing branches and getting rid of staff, a difficult task in a country with powerful unions and a tradition of consensus. Since 2000, the four biggest banks have closed about 1,000 branches and shed 50,000 jobs. In the short run, this has made their books look even worse than they did already. In 2003, for instance, Commerzbank wrote down the value of its financial and industrial assets by €2.3 billion. It also raised €760m in new capital and scrapped its dividend. But with luck, the worst should be over.

From the top

Improving costs and risk management are, however, only part of what German banks must do. They have to build their top lines too. Although they are still courting corporate customers—Commerzbank says that it wants to raise the proportion of German companies banking with it from 39% to 45%—they are now going after retail business with more enthusiasm.

Germans' demand for long-term savings and investment products, they reckon, is going to broaden and grow. Traditionally, German savers have been a cautious lot, fearing to venture beyond deposit accounts, life insurance and property. But in the late 1990s, many Germans overdosed on equities, thanks in large part to the privatisation of Deutsche Telekom and the rise of the Neuer Markt—a German version of America's NASDAQ stockmarket.

The craze disappeared the moment the market crashed: the Neuer Markt is now defunct, and Telekom shares have proved a poor investment. Yet although the daft days are gone, Germans are probably readier than they were ten years ago to consider different ways of saving and investing—for instance, through mutual funds. Despite the sluggish economy, this is still a wealthy country. And its people do

need to think about long-term investment: the state pension system, currently the font of 70% or more of retirement pay, is overloaded. The state is trying to encourage Germans to save more for their old age by offering them tax breaks, but so far they haven't shown much enthusiasm.

Deutsche has reintegrated its retail arm, formerly called Deutsche Bank 24, into its main operations. Not many years ago, it was thinking of spinning it off. Like big banks in other countries, it is trying to make use of the huge amounts of information it has about its customers to increase “cross-selling”—increasing the number of products per customer—through telephone sales and branch advisers. At the same time, says Rainer Neske, the head of retail banking, his staff are encouraged to aim for higher margins as well as volumes.

The biggest bet on a growing appetite for long-term savings products, however, was Allianz's purchase of Dresdner Bank in 2001. The underlying logic was lost in the coverage devoted to Dresdner's bad debts. The deal brought Allianz not only a network of bank branches (potential sales channels for its insurance policies and other financial products), but also Dresdner's asset-management arm, whose offerings could be sold by the insurer's 12,000-strong army of agents. Much of Allianz's business, says Paul Achleitner, its chief financial officer, has been built on life-insurance policies with tax privileges that are under discussion in Berlin. If the government reduces the privileges, the agents will need another product—“and guess what, we've got it.”

Act local

Although it is early days, Mr Achleitner says he is “very happy” about sales. “If you can customise bank products so that post-office civil servants can sell them, we can too.” The agency network may help Allianz to compete against the savings and co-operative banks, which also have powerful asset-management arms. Local knowledge and trust count: whereas big banks' managers tend to move around, small banks tend to be staffed by locals who know their customers well. But Mr Achleitner points out that he has lots of long-standing agents in small, rural villages “where the banks aren't”. The Allianz representative is “not a guy who keeps being rotated in and out”.

Even so, the three-pillar system—private, public and co-operative—continues to constrain banks' growth and to limit consolidation. Mergers can take place only within the pillars, not across them. Within the public and co-operative sectors, the number of banks continues to shrink. The impending end of state guarantees is shaking things up among the *Landesbanken*. Rating agencies have drawn up unflattering grades for their unguaranteed debt. The biggest, WestLB, has split itself into “public” and “private” bits. Two others, in Hamburg and Kiel, have merged and adopted a private-sector legal form: some think this new bank, HSH Nordbank, might buy its weaker brother in Hanover, NordLB, to create a big regional bank in the north. Another, Helaba, is forming closer ties with savings banks in Hesse and Thuringia, the states it covers.

For the big public-sector banks there are few options left. Some bankers and politicians fear that unless German banks grow, they will fall prey to foreign raiders. Cross-pillar consolidation, however, looks unlikely for now, despite occasional hints that something might shift.

Last year the mayor of Stralsund, a town on the Baltic coast, said that he wanted to put his savings bank up for sale. However, the state savings-bank law of Mecklenburg-Lower Pomerania, which covers Stralsund, would not allow this. More generally, under federal law any bank called a *Sparkasse* must be in public ownership. Even the scope for change within the public sector varies from state to state. In February one municipality in Rhineland-Palatinate sold its savings bank to a neighbour. This would not have been possible elsewhere.

There are other obstacles. The *Sparkassen* have a red “S” logo, a good marketing device for the public-sector banks. The public banks' association says that this could never be transferred to a private institution. It even frowns on vertical integration between *Landesbanken* and *Sparkassen*, although this has already taken place in some states, and further moves, such as Helaba's, are afoot.

Politics can change: one observer muses that Helaba might one day be married to Commerzbank. Others point out that cross-pillar deals need not mean that private-sector banks buy public ones: the shifts in the public sector, especially if the stronger *Sparkassen* link up with bigger *Landesbanken*, could create regional banks to be reckoned with.

Consolidation in the public sector might, in the end, be a necessary prerequisite for the private-sector

banks to bulk up their domestic business. There is little attraction in buying a single savings bank, except for one serving a big city: Mr Müller is only half-joking when he says he would like to buy the Stadtsparkasse Köln.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Rising again?

Apr 15th 2004
From The Economist print edition

The case for cautious optimism about Japan's financial system

IT ALL began, explains Shigeyoshi Kinoshita, with the family kimono shop. After the second world war, when many Japanese were short of cash, people would ask to borrow money against their kimonos. With his expert eye, Mr Kinoshita's father knew how much to lend. Thus the family moved into pawnbroking, and later into unsecured consumer loans.

In the early days, credit-risk assessment was based largely on trust. Now it is more sophisticated, and remarkably speedy. Applicants for loans can go to automatic booths, where their faces are recorded on camera and their documents are scanned. If their applications are approved, a plastic card that allows them to draw cash from ATMs is issued on the spot.

Mr Kinoshita's business grew into Acom, Japan's second-biggest consumer-finance company. About 70% of its borrowers are men, mostly spending the money on leisure and entertainment. They often keep their borrowing secret from their nearest and dearest. Borrowing is still stigmatised, and the industry has a shady reputation. The boss of Takefuji, the biggest consumer-finance outfit, recently pleaded guilty to wiretapping.

Borrowing cheaply from the banks and financial markets and lending at an average annual interest rate of 23%, Acom has a pretty lucrative business—despite the 12.9% increase in personal bankruptcies last year, which should mean more bad debts for consumer-finance firms. Now he is moving into store cards and credit cards. In most countries, companies such as his would at least have had to share their turf with banks. Not in Japan. Unlike Mr Kinoshita, the banks neglected consumers. Soaking up savings was the job of the state-owned post office; and providing loans was something that banks did for companies, not households.

Another difference between the banks and Mr Kinoshita was that bankers paid little heed to credit risk. Guided by officials from the Ministry of Finance, banks for many decades simply redirected money from savers to corporate borrowers pretty much as companies demanded and bureaucrats directed. Lending was based not on estimates of risk but on collateral. This often took the form of land, the price of which, especially during the 1980s, was confidently expected to keep rising.

Risk was thus socialised, rather than privately borne. This turned out to be calamitous, as the 13 years since the bursting of Japan's bubble economy have shown. The banks and the authorities took years to recognise and admit the scale of corporate Japan's bad debts. They hoped that Japan would grow its way out of trouble, but it did not. The economy continued to stutter and the pile of non-performing loans grew larger. Some banks failed, were nationalised or had to merge. The crisis cost more than mere money: some senior bankers took their own lives.

Until recently, there seemed to be no way out of Japan's banking mess. Even last year, the fifth-biggest bank, Resona, was kept going only by a ¥2 trillion ($17 billion) bail-out, and a large regional bank, Ashikaga, turned out to be insolvent and was nationalised. In the past few months, however, there has been an outbreak of cautious optimism. Banks and the economy appear to be on the mend. The Japanese, says James Fiorillo, an independent analyst in Tokyo, have been through “the most serious banking crisis in the 20th century and they've got away with never having a full-blown financial meltdown.”

Reasons to be cheerful

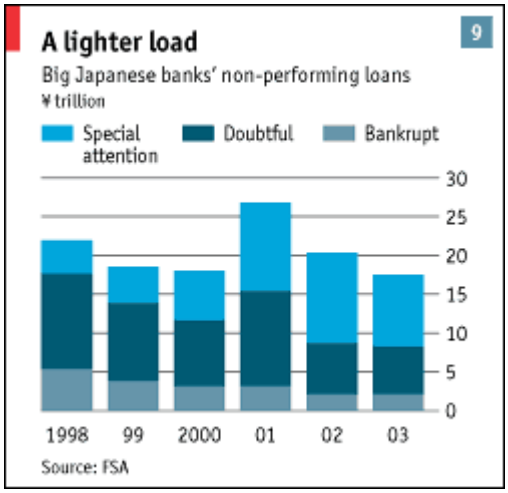
Besides the sharp rise in banks' share prices in the second half of last year, the clearest sign of this optimism has been the initial public offering in February of shares in Shinsei, formerly Long Term Credit

Bank. LTCB was one of three long-term credit banks that supplied finance to Japanese industry. It collapsed under the weight of its bad loans, many of which had been hidden in the books of subsidiaries, and was nationalised in 1998. It was bought by a group led by Ripplewood, an American venture-capital firm, and renamed Shinsei, which means “rebirth”.

Shinsei is now a universal bank, chasing retail business as well as making loans to corporations. It is run almost on American lines. It has had no qualms about ditching unwanted borrowers, and a lot of its information-technology processing has been shifted to India. For other Japanese banks, such offshoring is still taboo.

However, the rebirth of Shinsei is a one-off: its owners were given an astonishingly generous put option by the Japanese government, which agreed to buy loans should they deteriorate (they did). The flotation has earned its American investors a fortune. No one else will get such a good deal. Moreover, the new Shinsei has yet to prove its long-term profitability.

A better reason for optimism is that Japan's banks at last appear to have made serious inroads into their non-performing loans (see chart 9). According to the banks' supervisor, the Financial Services Agency (FSA), these peaked at 8.4% of the total in March 2002. By last September the figure was down to 6.5%, and has probably fallen further since then. The aim is to cut it to 4% by March next year.



Partly, this is because banks have helped borrowers out. However, it also reflects a marked improvement in the Japanese economy. Although consumer prices are not yet rising, the economy is now growing in both real and nominal terms: real GDP, indeed, grew at an annual rate of 6.4% in the fourth quarter of 2003. Exporters have done especially well. That has cut the flow of new non-performing loans, further helping the banks.

Economic recovery is one reason why analysts are not too bothered that corporate demand for credit is still declining. Companies are using their improved profits to pay back debt. “As far as larger companies are concerned, the debt-restructuring process is almost over,” estimates Hajime Takata, chief fixed-income strategist at Mizuho Securities.

There are other encouraging signs too. Banks have reduced their shareholdings in Japanese companies: the ratio has been cut, says Naoko Nemoto of Standard & Poor's, a rating agency, from 1.6 times tier-one capital to one-to-one. Rating agencies have been looking more kindly on Japanese banks for the first time in many years, (although their marks remain poor). Officials also point to the markets' measured reaction to the debacles at Resona and Ashikaga.

Some of the most interesting developments are taking place in smaller institutions. Tokyo Tomin Bank is proud of being the only one of the capital's banks not to have received a cash injection from public funds. Its president, Hiroshige Nishizawa, used the bank's own resources to write off bad loans and raised fresh capital from “graduates”—biggish ex-customers to which the bank had lent when they were small. Tokyo Tomin focuses on small-business lending: a speciality is the speedy provision of unsecured loans to firms that need cash—at a price, says Mr Nishizawa, that is based on risk.

Others see opportunities in the long-neglected consumer market. One is IY Bank, a subsidiary of Seven-Eleven Japan, the country's largest convenience-store chain. Three years old, it has 155,000 accounts and is adding new customers at the rate of 5,000 a month. Its draw is the convenience of the ATMs in Seven-Eleven's 10,000 shops: people can draw cash from their bank account, at IY or elsewhere, or on a loan card. IY's machines are also cheap. Most banks charge ¥105 for evening withdrawals and ¥210 after hours; IY's machines are free for its customers in the day and cost ¥105 after 7pm.

Also targeting consumers is Tokyo Star, which is owned by Lone Star, another American venture-capital firm. Its refitted branches are a shock of orange, in blazing contrast to their old, *sarariman*-suit blue, and feel similar to those of the most inventive American banks. Advisers—sorry, “coaches”—sit at kitchen-style tables, pull down charts from the ceiling to illustrate investments and loans, and scribble financial plans on wipe-clean boards.

There have also been changes out of customers' sight. In a typical Japanese branch, says Todd Budge,

Tokyo Star's chief executive, 80% of space is behind the counter. A lot of expensive retail space is thus wasted on back-office tasks that the company has now centralised. It is also making debtor-in-possession loans to companies in trouble, approving deals in three to five days that might take 30 elsewhere. Although avowedly a “Japanese” bank—the website is only in Japanese—Tokyo Star has a distinctly American management style. The old exclusive executive floor, says Mr Budge, is out; sandwich lunches and free-for-all discussions are in.

A long list of buts

Despite all this, it is too early to celebrate. The innovative retail banks are still few and far between. They face a hard task, not least because of competition from Japan Post: thanks to tax privileges, the mammoth post office holds half of households' savings and, to private banks' dismay, now plans to sell mutual funds.

More important, although the banks' health has improved, it is still not good. Hironari Nozaki, an analyst at HSBC, thinks that the banks' fundamentals have not changed: only the market's perception. He points to the high exposure of some banks to certain borrowers.

Those risks are at least known. More troubling, banks' balance sheets and inspections might not tell the whole story. In late January, the FSA began a special inspection of UFJ, one of the big four, when new documents came to light suggesting that the bank privately took a dimmer view of some borrowers than it admitted officially. Rumours continue to circulate: a Japanese financial magazine claimed recently that one big bank has ¥1 trillion of bad loans buried in subsidiaries, much as LTCB once did.

It is fair to say that some big banks are well thought of: Mitsubishi Tokyo Financial Group, which is set to own 15% of Mr Kinoshita's Acom, and Sumitomo Trust are mentioned most often. But praise for others is harder to elicit.

A further problem is that Japan's economic recovery has so far been limited to the export-oriented manufacturing sector. Many small companies outside that sector are still struggling and owe a lot of money, especially to Japan's 120 regional banks. In March 2003, says Mr Takata, manufacturers would have needed 7.4 years' cashflow to pay off their debts. That sounds manageable, and has probably got better since. Property companies, however, needed a daunting 19.6 years; retailers and wholesalers, 22.1; and construction firms, 23.7. Recent land-price data, he says, suggest that there has been some improvement.

Partly because of these loans, there will probably be more closures and mergers of regional banks, especially the smaller, “second-tier” banks. Many regional banks are well run, but quite a few are not. Some have close ties to local governments, which can cloud commercial judgment. Some, fed up with the low returns on Japanese government bonds, have come badly unstuck chasing higher yields—for example, by buying Argentine debt. Seeing trouble coming, the FSA is proposing a new law that would allow regional banks to ask for a capital injection even if their accounts show that they are solvent. They might even be able to ask for funds if their capital exceeds 4% of their risk-weighted assets, the minimum for domestic banks. Perhaps some of the banks' books do not reveal the whole truth.

It is too soon to say whether Japanese banks as a whole have shed their bad habit of lending without putting a proper price on risk. That will not be clear until the demand for credit picks up again. Ms Nemoto thinks that “they are still seeking volume” rather than concentrating on improving profitability. As Akio Mikuni, head of Mikuni & Co, a rating agency, puts it: “Basically, I don't think we've given up the idea of socialising credit risk and market risk yet.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Rooting for branches

Apr 15th 2004
From The Economist print edition

Mergers are not the only avenue to growth, nor necessarily the best

ON SEATTLE'S frequent rainy days there are, thank goodness, plenty of places to have a coffee while you dodge the showers. There is Starbucks, of course, or Tully's. Or you can always go to the bank.

The bank in question is Washington Mutual (WaMu). Based in Seattle, it has been in the vanguard of the revival of branch banking in the United States. It has not only been opening branches in one city after another, but also changing the way they look. So there is coffee on sale, as well as chocolates and piggy banks shaped like footballs, and there are play areas for children. It all feels more like a shop than a bank, and it is meant to. WaMu's model is not other banks, but America's most successful retailers, such as Wal-Mart and Home Depot.

Some “stores”, as WaMu calls them, have even handed out “Action Teller” dolls dressed like the staff. A real-life WaMulian (yes, that is what they call themselves), in checked shirt and khakis, greets customers as they enter. There are no counters and no ropes funnelling people towards the tellers. Instead, some employees stand at “teller towers”, dispensing advice or leading customers to colleagues who can help them with a loan or a mortgage. Customers who want cash are given a numbered receipt: they punch the digits into an ATM that yields banknotes and spits out coins.

WaMu, once a modest Seattle thrift, has grown at astonishing speed. Its assets have doubled in the past seven years and now stand at $275 billion, making it America's seventh-biggest bank. It jockeys with Wells Fargo for leadership of the national mortgage market. Although it bought its way to the top rank, it now grows mainly by opening new branches. When it started doing this about five years ago, says Kerry Killinger, WaMu's chief executive, “no one thought branching made much sense.” Among big banks the fashion then was to steer customers towards the telephone and the internet. Branches were old hat.

The bank aims for high-growth markets plus a few other cities where it sniffs a chance. It sets up mortgage-only businesses and then follows up with a splurge of its innovative branches (which the company calls “Occasio”, Latin for “favourable opportunity”). The first target was Las Vegas. “The approach worked extraordinarily well,” says Mr Killinger, with the branch turning a profit inside 15 months. WaMu then moved on to Phoenix, Atlanta and Denver. In New York it bought Dime Savings Bank, giving it 350 branches, to which it has been adding. Last year it opened 90 branches in Chicago. It now has 1,800, including 300 Occasio stores. It plans to open 250 in the new style this year, including another 50 in Chicago and 30 in its next target markets, Tampa and St Petersburg in Florida.

The new branches are supported by a mixture of orthodox and quirky marketing. In Chicago, a fiercely competitive market, WaMu offers at least 1% interest on its Platinum checking account; customers in Las Vegas start at 0.15%. When they landed in Chicago, WaMulians handed out purses containing $1.50, to advertise the fact that it does not impose the usual surcharge on other banks' customers who use its ATMs. To announce its arrival in New York, Mr Killinger recalls, WaMu bought out Broadway's theatres for a day and gave the seats to the city's teachers. The gesture won it customers.

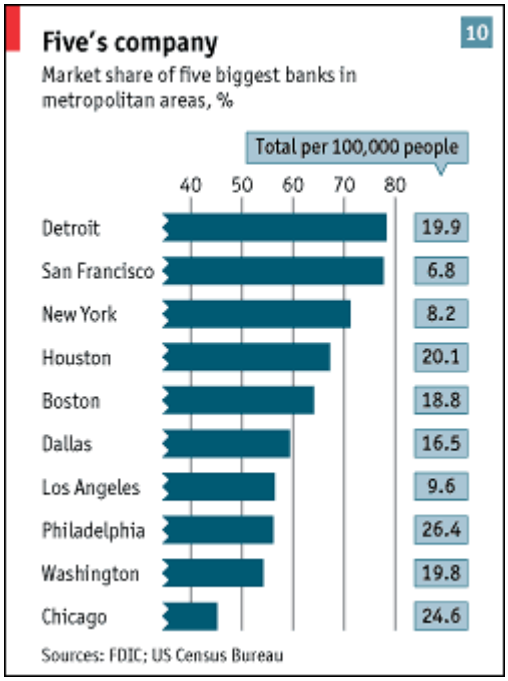
Other banks have now rediscovered the merits of the branch. “In 1999 and 2000,” says Todd Thomson, chief financial officer of Citigroup, “conventional wisdom was that branches were bad.” No longer. The success of WaMu, Commerce Bank and others has been only one influence in the change of mind. Brokers such as Charles Schwab and mutual funds such as Fidelity, too, were building branches and attracting customers. “What we understand is that stores are good,” Mr Thomson says. “People like to go to a real physical presence. It feels safe. It feels solid.”

For the past few years America's banks have been on a branch-building spree. The leading banks, including WaMu, have opened about 1,000 new offices in the past four years, and plan to step up the pace. Bank of America alone has plans for 350. Bank One's head of retail banking, Charles Scharf, says

his bank has been adding branches for the first time in five years. It too has teller towers now, and places for children. “We look a lot more like a retailer than we used to,” says Mr Scharf.

The fight for Chicago

Nowhere is the battle of the branches fiercer than in Chicago. The city's market is fragmented, a legacy of Illinois's old banking laws, which until a few years ago forbade branching across county lines. Last June, just before WaMu arrived, the top five banks had a combined share of under 50% of deposits. In most big cities, 70% is more usual (see chart 10). Chicago's market leader, Bank One, had 20%; next came LaSalle Bank, owned by ABN Amro of the Netherlands, with 12% and Harris Bank, owned by Canada's Bank of Montreal, with 9%. There is also a host of small community banks. In all, the city has 300 banks or savings institutions.

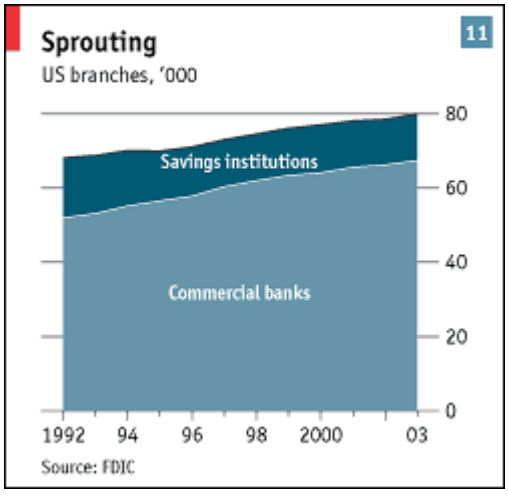


Branches are sprouting everywhere. Yasmin Bates of Harris Bank says that if all the planned outlets in Chicago go ahead, they will account for half of all the new branches in America in the next few years. Harris itself intends to expand from 154 branches to 200 by 2006. Bank One added 20 in and around the city in 2003, and plans another 30 this year. It is also replacing all its ATMs and increasing by 50 the number in Walgreens drug stores.

BofA and Fifth Third, another bank growing through branching, also want more offices. Whether everyone will build as much as they want is an open question. Some counties in the Chicago area think they have enough already. They would rather have more shops, which unlike banks generate sales tax.

It is too soon after WaMu's entry into Chicago to say how it is doing. Bank One says that its own market share grew last year. “If WaMu is getting any market share,” says a spokesman, “it sure isn't coming from us.” Others are prepared to concede that WaMu has made an impression. “We've seen some erosion,” says David Rudis, head of retail banking at LaSalle. “They've picked it up from everybody.” The incumbents, not surprisingly, make a good deal of their local roots. “Everyone knows Harris Bank,” says Ms Bates. “We don't have to introduce ourselves.”

Nonetheless, Mr Killinger sounds confident, and thinks that the opposition is rattled. “For our purposes it's very amusing that the market leader put together a playbook [an American football team's book of strategies] on us.” Yes, says Bank One, it did develop a WaMu “playbook” when the Seattleites came to town. It claims, however, that this was to rally its Chicago bankers “to do an even better job against all the competition.”



Mr Killinger says that after opening stores in a new city, he expects to lose money for the first few months and go into profit after 15-18 months. “Our model has worked in every market we've gone into around the country,” he says. As for the locals' home advantage, he points out that the mortgage business has paved the way. Before opening bank branches in the city, WaMu had become the leading home-lender in Illinois.

Having neglected branches for so long, have America's banks now gone too far the other way? Winning market share can mean losing money. One possible sign of trouble is a decline in mortgage business in the fourth quarter of 2003, which was foreshadowed by the rise in bond yields from their deep dip earlier in the year. WaMu said in December that it would be laying off several thousand people in mortgage-processing centres across America, and has now begun to do so. Because of the cycle, says Mr Killinger, parts of the business are contracting but others are growing. He still expects profits to rise in 2004.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

McBank's

Apr 15th 2004
From The Economist print edition

The remarkable rise of an American retailer

WHEN other banks merge, says Vernon Hill, “we love it.” He leafs through a fat book of slides before alighting on the telling page. The growth of deposits at Commerce Bank, which he founded in 1973, surged after each of two mergers on his patch: First Union's purchase of CoreStates in 1998 and Fleet's acquisition of Summit in 2000. Acquisition, says Mr Hill, “is a good way to lose customers. It dilutes your model, dilutes your culture, distracts your firm and dilutes your brand. No great retailer ever grew by acquisition.”

Mr Hill insists on calling himself a retailer, not a banker, extolling Wal-Mart and McDonald's. Commerce's hours are much more like those businesses' than a bank's. Branches are open from 7.30am to 8pm on weekdays and from 11am to 4pm on Sundays. Like McDonald's, Commerce has its own university, where 75 full-time trainers instil the company's values into new recruits. Like any owner of a retail chain, Mr Hill is fanatical about the growth in like-for-like sales (deposits, if you must), after stripping out the effect of new outlets. That growth has been remarkably fast, running at an annual rate of close to 30% in the past couple of years.

On top of this, Commerce has been opening branches at a furious pace. At the end of 1998, it had 96 outlets and $4.9 billion in deposits. Having spread from its New Jersey origins to Philadelphia, it has started to attack Manhattan. Cheekily, too: when Chase, the local market leader, moved a downtown branch from the ground to the first floor, Commerce opened up downstairs. It now has 275 branches and $20.7 billion in deposits. Next on the list is Washington, DC. By 2009, Mr Hill plans to have 700 branches.

Roll out the welcome mat

Despite the pace, Mr Hill says he plans branch locations carefully. The interiors are more welcoming than at most banks. Someone greets you when you enter, and there are no screens to separate customers from tellers (a rarity in New York, where robberies are frequent). There are penny arcades where you can convert your loose change free of charge, and maybe win a little prize. Mr Hill's wife, who runs an architectural and design business, is in charge of the way the branches look.

Businesses that expand this fast often come a cropper, yet Commerce is making money. Unlike a lot of aggressive new entrants, it does not seem to be buying market share. Although Mr Hill's main aim is to take in money as fast as he can, his bank's deposit rate is below that of its competitors. He says his average cost of funds last year was only 0.82%. “A [banking] licence”, he declares, “is government authority to borrow money cheap.”

The advantage of the long opening hours seems to outweigh the extra cost. Maybe it shows that convenience matters in banks as well as burger joints. Bigger banks, says Christine Detrick of Bain, a consulting firm, concentrated on the “mass affluent”—richer people with money to put into stocks and shares—and “lost the middle class to Commerce”.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

From Wild West to Wal-Mart

Apr 15th 2004
From The Economist print edition

How to get the most from cross-selling

PHILIP FRADKIN was lucky with the raw material for his book “Stagecoach”. Many corporate historians have to make do with dry balance sheets and dusty boardroom minutes. His subject, Wells Fargo, was founded as an express-delivery company and bank in 1852, during the California gold rush. By the time the two businesses were split half a century later, there had been gunfights with outlaws and Indians, run-ins with railwaymen and the United States Post Office, not to mention frequent embezzlement and occasional hangings. Wells Fargo was even represented at the OK Corral: Morgan and Wyatt Earp were company messengers.

Although the stagecoach remains its logo, the modern Wells Fargo, America's fourth-largest bank, is only an indirect descendant of its romantic predecessor. The express business, crippled by railways and regulation, was nationalised in 1918. The old bank bumbled along unremarkably for most of the 20th century, but ran into deep trouble in the 1990s and was taken over in 1998 by Norwest Bancorp, a Minneapolis bank. Norwest, knowing a good name when it saw one, took Wells Fargo's.

Even so, the new Wells Fargo has two things in common with the old. The first is an apparent indifference to what goes on east of the Mississippi. Although it sells mortgages across America, all its branches are in 23 western states. For now, it says it is too busy selling to customers there to be distracted by, say, J.P. Morgan Chase's purchase of Bank One. Second, just as the old company supplied more than one service (express delivery of goods, valuables and mail, as well as banking), its modern counterpart is determined to “cross-sell” all kinds of financial services (supplying its customers with bank accounts, insurance, mortgages, broking, you name it).

Banks have been trying to cross-sell to their customers for many years. They have been more successful with corporate clients, says Mr Scharf of Bank One, than with retail customers. Increasingly, however, banks are targeting their retail business, where the potential rewards are higher than ever. Think of the merchant fees from debit cards and credit cards; the costs saved if customers pay their bills via the

internet; the arrangement charges and interest payments on mortgages; the insurance premiums; and the management fees from mutual funds. It all adds up.

It does not sound all that hard. People need, or want, more and more of these products. Banks can supply most of them, and have bags of information about their customers' finances. In some countries, notably France, Italy and Spain, insurance policies have been sold successfully through banks for donkey's years. Yet banks have mostly struggled to sell a range of products to their customers. Even if cross-selling can be made to work, it may not be all that profitable. Most of the financial products that the average consumer wants are standard, commoditised stuff.

“The products are commodities,” says Richard Kovacevich, Wells Fargo's chief executive. “The way you distribute them is not.” Mr Kovacevich, who once worked for General Mills, a big retailer, points to Wal-Mart. It put under one roof a huge assortment of products that used to be sold separately, creating great efficiency gains. Enormous quantities of goods were going to one place, allowing unit merchandising costs to be cut. Some of the savings could be passed on to customers in lower prices. “The bad news is that this is hard to do,” says Mr Kovacevich, before adding: “The good news is that this is hard to do.”

Whoever gets it right, in other words, can make a packet—and then make life much more difficult for would-be rivals. Look what happened, he goes on, when Wal-Mart started selling food. Food retailing is a low-margin business in most countries, which has no obvious synergies with general merchandising. Wal-Mart went into it because consumers visit food stores more often than they do general merchandisers. Its non-food sales went up dramatically because people were coming to Wal-Mart more frequently. That hurt the competition on both sides of the business, because other general merchandisers were not in the food business, and vice versa.

Wells Fargo tries to do much the same thing. The financial-services industry used to administer its products separately, so customers were in effect paying for several different sales forces. The trick is to bring all of them together, cut costs and pass some of the savings on to customers. Wells Fargo does this by offering “packages” of services. Take five products—a checking account, a credit card, a home-equity credit line or loan, a savings account and online banking—and you might save $300 a year, compared with buying each of them separately. Or buy a package of services when you move house—the likeliest reason for Americans to change banks—and you might gain $340 a year. And so on.

This analogy with retailing explains why Wells Fargo and other banks are keen to sell such a broad range of services. Wells Fargo is in every corner of the financial-services business except investment banking. Before giving up a line of business, says Mr Kovacevich, banks ought to “think about defence”. For example, if you sell your credit-card business to competitors because you don't see much value or scale in it, they might offer your former credit-card customers services that you would rather sell yourself. Why hand a cross-selling opportunity to the competition?

Such thinking also helps to explain why many banks have been so eager to rebuild their branch networks. WaMu's tellers don't stand at their towers to look cool: their job is to find out what financial services people want, and to lead them to a colleague who might sell them a loan or an insurance policy as well. Up to a point, banks can try to cross-sell over the phone: speak to your credit-card company, and you will probably be asked if you want to transfer balances from other cards you may have. But some customers get annoyed by telephone selling, and in a branch a bank might sell a lot more.

The urge to cross-sell is the reason why, for example, Bank One has spent so much on opening new branches, refurbishing old ones and adding 1,000 “relationship bankers”. Mr Scharf says that his bank is “really just beginning to get traction on cross-selling”. These relationship bankers open almost every account, and take the opportunity to find out what other needs a customer might have.

Seize the moment

It pays, says Gerard du Toit, a consultant with Bain, to give a lot of attention to new customers. “The best time to sell customers another product is when they are brand new. Two years later, their needs have probably changed. Companies miss opportunity after opportunity to make customers loyal.” Mr Scharf says that his relationship bankers follow up with their customers soon afterwards, “because we know that is the best time to provide additional products.”

Trying to cross-sell to existing customers is harder, even though banks have a great deal of information about them. A monthly bank statement, for example, tells you a lot about their income and expenditure,

the size of their mortgage, the name of their mortgage lender, regular payments into savings and investment schemes and so forth. However, banks have hitherto been poor at converting such data into knowledge about customers' requirements and thence into sales. For example, they have tended to keep separate records for banking, home loans, brokerage, insurance and so on. All-in-one databases, however, are easier to visualise than to create. “Everyone knows it's buildable,” says Mr Kovacevich, “but it's huge amounts of information.” Wells Fargo spends $500m a year on such technology.

Wells Fargo seems to be ahead of the pack—although some, such as WaMu, may disagree. Under Mr Kovacevich, it has been hugely successful, with revenues and earnings growing at double-digit rates. The markets love it: it has the highest p/e ratio of all American big banks, except for two on the point of being taken over. The rating agencies love it too: last September Moody's gave Wells Fargo a triple-A rating, the first such accolade for an American bank since 1995.

Even so, it says it still has a lot to do. There is no standard measure of success at cross-selling. The usual statistic is the average number of products bought by each customer, but this can be easily manipulated: do two savings accounts count as two products or one? Still, Wells Fargo reckons that the average American household has 16 different financial products. The bank supplies just 4.3 to its average customer. “On a scale of 1 to 100,” says Mr Kovacevich, “we're only at 20-25.” Only 11% of banking customers buy insurance from the company. Even though Wells Fargo issues more mortgages than anyone else in the United States, only 16% of its customers have a mortgage with the bank.

On the other hand, Wells Fargo sees its own customers as a great growth opportunity—better than opening new branches or buying other big banks, as its rivals are doing. Mr Kovacevich says that 80% of the bank's growth comes from selling additional products to existing customers. The cost of selling to someone already on the books, he says, is one-tenth that of attracting a new customer.

If banks find it so hard to emulate Wal-Mart, why shouldn't Wal-Mart apply its cross-selling skills to finance? It has started, in a small way, by offering basic banking facilities in 800 of its stores, in conjunction with local banks. Some British supermarkets have also set up banking businesses, in alliance with some of the country's leading banks. One, Tesco, sells insurance too. The attraction is plain: retailers have strong, trusted brands and a huge reservoir of loyal customers, most of whom visit once a week. They also handle large amounts of cash.

American law forbids commercial companies such as Wal-Mart from owning banks. They may, however, own industrial loan corporations (ILCs), state-registered bodies that are banks in all but name. A bill passed by the House of Representatives in March would allow ILCs to branch across state lines without being regulated by the Federal Reserve. This extra freedom would make them much more attractive to non-banks. However, similar bills have failed in the Senate in the past.

Wal-Mart's banking ambitions have been thwarted before. In 2002 it tried to buy an ILC in California but failed in the face of lobbying from local banks. The state instead chose to bar non-commercial firms from buying ILCs. If the mighty merchandiser got the chance, it might go into banking with a vengeance.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

An immeasurable asset

Apr 15th 2004
From The Economist print edition

Trust is hard to evaluate, harder to gain and easy to lose

LIKE Fritz Vogt in Gammesfeld, Alexander Hoare has banking in his genes. Mr Hoare's is the 11th generation to run the family bank in London, C. Hoare & Co. In the partners' room, he sits next to his ninth cousin (they share a forefather with many “greats” in front). The banking hall in the Fleet Street branch (the other is in Knightsbridge) looks much as it did in 1820. The ledger recording the financial affairs of the 17th-century diarist Samuel Pepys, an early customer, is in the bank's museum.

There are obvious differences between the two banks. Customers of Hoare's, founded in 1672, are mainly wealthy; those of Mr Vogt's co-op are ordinary villagers. Whereas Mr Vogt has rejected modern technology, Mr Hoare, who used to work for a technology consultancy, embraces it enthusiastically. Yet there is a similarity, which has something to do with their small scale. Both banks know their customers well, which means that there is trust on both sides.

Mr Vogt's customers are his neighbours. Mr Hoare asks prospective clients for two introductions. To be accepted, they must pass both “quantitative” and “qualitative” tests. The first has to do with whether both bank and customer will gain financially; the second means, he says, “a meeting of minds on how to do business”, and “treating them as we'd like to be treated ourselves”. Private ownership helps, he thinks: Hoare's is possibly the last unlimited-liability partnership left in banking. At both banks, the customers stick around. Mr Hoare explains that of his 10,000 customers, “half are very well known to the bank.”

Big banks would love to enjoy similar trust. Not only would it make customers easier to attract and keep, but the potential rewards from trust are rising as incomes increase and financial products cover an ever broader range. Looking after someone's current account might not be worth much, if he stays in credit. But persuade him to take out a mortgage with you, to have a credit card and to switch his small-business accounts to your bank, and he looks much more lucrative. Better still, having thrown in his lot with you, he is likely to stay.

Banks used to be able to count on their customers' loyalty—or, almost as good, on their apathy. People used to stay with “their” bank pretty much for life, switching only when they had to, perhaps because they were moving to a different state in America or a different town in Germany. This lucrative inertia is still there to be exploited: indeed, thanks to deregulation and mergers, these days it is much easier for Americans to stay with the same bank when they move house.

But it has become easier than ever to switch between financial-services firms. Banks encourage defectors from rival banks by taking care of the cumbersome details—making sure all the automatic bill-payments

are carried over, and so forth. Credit-card companies often offer six months' free interest on balance transfers. Mortgage companies offer special deals to borrowers switching from a competitor. And it can all be done with a few clicks of the mouse.

As this survey has argued, many banks have realised that they spent too many years making it harder for themselves to win customers' trust. Too much effort went on cutting costs and not enough on increasing revenues. A lot of banks now understand that they got something wrong: hence America's splurge of investment in bank branches.

Widely unloved

Alas, the vast majority still have a lot of work to do. Mr du Toit of Bain says that organic revenue growth—ie, after stripping out the effects of mergers—can be predicted fairly well by customers' answers to a simple question: “Would you recommend this company to a friend?” The results for larger banks, he says, are “consistently lousy”. The ones that come out best are the upstarts which have pioneered shop-style retailing, Washington Mutual and Commerce Bank. Besides WaMu, almost no big American banks—perhaps surprisingly, not even the well-regarded Wells Fargo—score well.

But surely big banks' brands are an asset? Maybe. Their names are well known, and seen on every high street—just like those of the top retailers they are trying to emulate. Many of their logos and advertisements are instantly recognised. And yet bank accounts, pensions and mortgages lack the appeal of cars, fashionable clothes and holidays in the sun. “People are as excited about their banks as about their power companies,” says Mr du Toit dismissively.

Worse, banks continue to make their own task more difficult. Their preferred means of acquiring new customers—takeovers—seems to be a well-proven method for annoying and losing old ones. Financial institutions have often been too eager to push their products, with expensive results for their customers. Those “free” credit-card deals often turn out to cost a lot. In Britain, some banks have been rapped over the knuckles by regulators for selling unsuitably risky investments to retail clients. Insurers—whose products banks are eager to promote—are also in hot water for the poor performance of their “with-profits” policies, which many Britons had hoped would pay off their mortgages.

In America, banks have been tainted by scandal. Admittedly, many of the worst stories have been on Wall Street not Main Street. But some Wall Street firms—the broker-dealers and the universal banks—also have retail customers who were bilked in the bubble years. Since then, some of the same institutions (as well as others) have been caught up in scandals over mutual-fund trading.

Perhaps banks cannot have it all. Many banks have done astonishingly well in the past couple of years, and success is not always popular. Look at the critical reaction when one British bank after another announced healthy profits earlier this year. You might think that such profitable companies must have some satisfied customers, but the banks found themselves denounced as extortionists in pin-stripes.

Maybe trust does not matter all that much. Banks in America and Britain, in particular, are doing pretty well on limited supplies of it. Yet the best retail bankers—those new role models—enjoy it by the bucketload. That must be worth having. In the end, the nice guys might even do better than the rest.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Sources and acknowledgements

Apr 15th 2004
From The Economist print edition

Many people were of great help in the preparation of this survey besides those quoted in the text. The author would especially like to thank David Rhodes of Boston Consulting Group; Mike Baxter and Ron Langford of Marakon Associates; Frederic Mishkin of Columbia Business School; Hiroshi Nakaso of the Bank of Japan; Bill White and his colleagues at the Bank for International Settlements; and Ken Guenther of the Independent Community Bankers of America.

Books

"The Economics of Money, Banking and Financial Markets", (7th ed) by Frederic Mishkin, Pearson Addison Wesley, 2004.

"European Retail Banks—An Endangered Species?", by Andreas Dombert and Holdger Kern, John Wiley, 2003.

"Banking in Asia: Acquiring a Profit Mindset", (2nd ed), by Tab Bowers, Gred Gibb and Jeffrey Wong, John Wiley, 2003.

"Saving the Sun: Shinsei and the battle for Japan's Future", by Gillian Tett, Random House, 2003.

"The Financial Crisis in Japan during the 1990s: How the Bank of Japan Responded and the Lessons Learnt", by Hiroshi Nakaso.

"Japan's Policy Trap: Dollars, Deflation and the Crisis of Japanese Finance", by Akio Mikuni and Taggart Murphy, Brookings Institution, 2002.

"Stagecoach: Wells Fargo and the American West", by Philip Fradkin, Free Press, 2002.

Papers

"Potential Competitive Effects of Basel II on Banks in SME Credit Markets in the United States", by Allen Berger.

"Will the Proposed Application of Basel II in the United States Encourage Increased Bank Merger Activity? Evidence from Past Merger Activity", by Timothy Hannan and Steven Pilloff.

"Cyclical Implications of the Basel II Capital Standards", Ani Kashyap and Jeremy Stein.

"Capital Standards for Banks: The Evolving Basel Accord", *Federal Reserve Bulletin*, September 2003.

"Recent Developments in Business Lending by Commercial Banks", by William Bassett and Egon Zakrajsek, *Federal Reserve Bulletin*, December 2003.

73rd annual report, Bank for International Settlements, published June 2003.

Quarterly Banking Profile, Federal Deposit Insurance Corporation.

FDIC *Outlook*, Spring 2004.

Many of the data in charts and text were taken from the websites of the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System. Data from the European Central Bank and the Bundesbank were also used.

Besides the work by consulting firms cited in the text, publications on banking subjects on the websites of Mercer Oliver Wyman and Boston Consulting Group also proved useful.

Fritz Vogt and the Raiffeisenbank Gammesfeld, described at the very start of the survey, were the subject of "Schotter wie Heu", a film made in 2002 by Wiltrud Baier and Sigrun Kõhler.

There is also plenty of information about Basel II on the website of the Bank for International Settlements.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Apr 15th 2004
From The Economist print edition

Reprints of this survey are available at a price of £2.50 plus postage and packing. A minimum order of five copies is required.

Send orders to:

The Economist Shop
15 Regent Street, London SW1Y 4LR
Tel +44 (0)20 7839 1937
Fax +44 (0)20 7839 1921
e-mail: shop@economist.com

Corporate offer

For corporate orders of 500 or more and customisation options, please contact the Rights and Syndication Department on:

Tel +44 (0)20 7830 7000
Fax +44 (0)20 7830 7135
or e-mail: rights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Linux on desktop PCs

More balls through Windows

Apr 15th 2004 | SAN FRANCISCO
From The Economist print edition

Is Microsoft finally about to face real competition in desktop-computer software?

Get article background

FOR years, hope has ebbed and flowed among many in the computer business that Linux, a freely available computer operating system which uses a penguin as its symbol, would become a viable alternative to Microsoft's Windows, the near universal standard for the world's personal computers. The industry—excluding Microsoft and its founder Bill Gates, of course—is currently riding another wave of hope. Will disappointment follow?

Within the past month, some of the world's most powerful technology firms have pledged considerable support for Linux on the desktop. Hewlett-Packard (HP), which runs neck-and-neck with Dell as the largest seller of PCs in the world, said it will begin shipping some machines that run on Novell's flavour of the free operating system, called SuSE Linux. And Sun Microsystems, an arch-rival of Microsoft, announced—even as it was preparing to bury the hatchet with Microsoft officially—that it had persuaded Wal-Mart, the world's biggest retailer, to sell cheap PCs using Linux and Sun's StarOffice suite of application programs, instead of the ubiquitous Microsoft Office. This follows a deal that Sun struck last autumn with several Chinese ministries to ship up to 1m PCs with Sun's Linux package to China this year, rising to “tens of millions in future years,” according to Jonathan Schwartz, Sun's chief operating officer.

Is this the beginning of the end for Microsoft's virtual monopoly on the desktop? Certainly not right away, says Al Gillen, an analyst at IDC, a technology consultancy. Today, almost 94% of all PCs in the world run on Windows, while slightly more than 3%—mostly in creative industries and universities—use Apple's Macintosh system. Fewer than 3% use Linux. By the end of the decade, Linux's share could grow to 7-10%, reckons Mr Gillen, displacing Macs as the main alternative. That would still fall far short of Linux's growing popularity in the market for powerful server computers. Linux aficionados, however, say its chances on the desktop should be much better.

They cite several reasons why. First, the quality of Linux—which like other open-source software is developed by a community of volunteers who share their work freely—has been rising steadily. Linux PCs are no longer just for geeks. Second, Microsoft itself looks temporarily chastened, if not weak. A series of worms and viruses has wrought havoc on Windows PCs. Microsoft faced further embarrassment this week when it warned about more security flaws in its software. Meanwhile Linux, which hackers tend not to target, looks safe in comparison. And distrust of Microsoft as a bullying monopolist remains high. Last month, the European Commission fined the company €497m ($612m) and ordered it to behave better.

More specifically, two windows, so to speak, of opportunity appear to be opening. One is that the next version of Windows, called Longhorn, has been delayed to 2006 at the earliest, in part by Microsoft's realisation that it has to tighten up security a lot more. So, for the next two years, companies and home users thinking about updating their operating system might be reluctant to buy the current version, Windows XP, knowing it will soon be overtaken. Hence they may consider alternatives more seriously. If Linux can establish a good reputation during this period, it might look even more attractive once Longhorn, which will be expensive and is likely to require new hardware, is released. Linux, after all, can be very cheap: $100 per user if bought as part of Sun's package, for instance. It can even be downloaded for nothing from the internet.

Starting from scratch

The other opportunity lies in poor countries. Unlike rich countries, which have a huge installed base of Windows computers and billions of documents in Microsoft's fiddly file formats, most users in Asia and South America are starting with a clean slate. For a country such as China, says Sun's Mr Schwartz, the attraction of open-source software is obvious: it is cheaper, so it will reduce the incentive to get pirated software (most copies of Windows in China are fake) and thus help China improve its relations with the World Trade Organisation. Better still, it allows China to avoid being locked into a single vendor—and an American one at that.

On the other hand, despite improvements Linux faces real obstacles. It can still be a nightmare for home users to install and, unless bought as part of a commercial package such as Sun's, it does not come with a help-desk. Worse, there are still too few applications. Fewer than 1% of all computer games, for instance, work on Linux. Software to manage personal finances or organise digital photos is also missing. In theory these programs could all be written but, without a huge increase in users, code-writers will not bother.

This is why even some of Linux's main backers have relatively modest ambitions for the operating system. “There is no real market for a consumer-grade Linux desktop,” says Martin Fink, HP's Linux boss. Rather than trying to upstage Microsoft, HP is simply responding to its corporate customers, whose technology bosses have been asking to try out Linux on the desktops of a few dozen employees before committing to any big deployment. “They are at the point where they want to kick the tyres,” adds Mr Fink.

Linux's main appeal, in other words, is likely to be to companies rather than home users. And even companies are unlikely to ditch their Windows PCs for the sort of employees that Microsoft calls “information workers”—the lawyers, consultants, accountants and so forth who use presentation applications, spreadsheets, fancy graphics and the like. Linux is perfect, on the other hand, for call centres, cash tellers, customer-support departments and other types of work that require employees to use only the same one or two computer functions (and whom their employers might actually want to discourage from goofing off with other applications while on the job). Instead of the “information worker”, says Mr Fink, he is targeting the “transaction worker”.

That casts a different light on Linux's future on the PC. Companies such as HP do not see it as a way to make money, but as a way for them to drive sales of server computers in company data-centres as part of a complete Linux “solution”. And Sun, according to Pip Coburn, an analyst at UBS, a bank, probably “aims to distract folks in suggesting that Microsoft—certainly damaged by Linux in servers—will get burned at the desktop.”

So Microsoft may not need to worry about Linux on PCs all that much. Insofar as it can point to competition from Linux, as it has been doing with Apple, as “proof” that it is not a monopoly, Linux may even help Microsoft in its legal battles.

But the future is uncertain, and Linux still might yet represent another kind of threat to the company. No standard operating system has yet emerged for mobile handsets, robots, watches, televisions, printers, car gadgets and other such devices. Microsoft, naturally, wants to extend Windows' dominance to these as well. It is here, rather than the desktop, that Linux could be a real threat to the mighty company's ambitions.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

McDonald's

Burger and fries à la française

Apr 15th 2004 | PARIS
From The Economist print edition

French lessons for the world's biggest fast-food firm

CAN a Frenchman revive Europe's appetite for the Big Mac? Denis Hennequin, who ran McDonald's in France, is now trying to repeat the success he had in his home country as the new head of the American fast-food giant's European operations. On April 13th, McDonald's said that, while it expects first-quarter profits to improve thanks to renewed growth in America, sales in Europe hardly grew at all.

Though it seems unlikely, France is the only place in Europe that has consistently loved McDonald's since the first outlet opened there in 1979. McDonald's might well be an icon of American culture and globalisation in a country whose people take to the streets to protest against both. And fast food would seem foreign in a society where a one (or two) hour break for lunch is still sacrosanct. Yet the French cannot seem to get enough of their “McDo”. A recent study by MKG Consulting in Paris found McDonald's largely dominates the French restaurant sector, dwarfing rivals such as Elior, a French fast-food group, and Quick, a Belgian chain. McDonald's now has some 1,040 restaurants in 750 cities in France, now its most profitable European subsidiary.

Why is McDonald's doing so well in France? Mr Hennequin summarises his strategy for France as “upgrading and transparency.” He spruced up drab restaurants, improved the menu and introduced visitor days. Despite a long conflict at one Paris branch over low pay, which ended last year, he managed by and large to be on good terms with the country's combative unions. McDonald's wisely took a low profile in a court case against José Bové, an anti-globalisation campaigner who trashed a McDonald's restaurant in the southern French town of Millau in 1999.

McDonald's was clever in adapting food and décor to local tastes and concentrating on children, says Nicolas Bloch at Bain, a consultancy. The ham-and-cheese “Croque McDo” is McDonald's version of a *croque monsieur*, a French favourite. McDonald's teamed up with French companies to offer local fare, for instance fruit yoghurts produced by Danone, coffee from Carte Noire and the French soft drink Orangina. McDonald's France buys 80% of its products from French farmers. It has even advertised in newspapers how many French cows, chicken, lettuce and tomatoes it uses each year.

Designer salads

Mr Hennequin will try to apply some of these lessons to other European countries. Sales in Germany and Britain, the two most important European markets, are sluggish. Italy and Belgium remain tricky. He established a “food studio” and a “design studio” at the company's base in Guyancourt near Paris to research and develop new products and funkier interior designs for Europe's restaurants. Under the stewardship of Olivier Pichot, a French three-star chef, the food studio's first big foray was recently launched in Britain and Germany: “Salads Plus” adds eight healthier items to the staple of burgers and fries.

McDonald's calls the new salad menu “a strategic change in the positioning of its menu in Europe”. It is a response to the rise of “fast casual” restaurants such as Cosí, a gourmet sandwich shop, and to concern over obesity. In America the company has already introduced a range of new salads.

Europe's salad offensive also fits into the strategy of Jim Cantalupo, McDonald's chief executive, who took over at the beginning of last year after the company hit a rough patch, which included its first quarterly loss since going public in 1965. Mr Cantalupo aims to reverse a diversification drive and to grow organically. “Focus on the core business is his *leitmotif*,” says Mr Hennequin.

If Mr Hennequin manages to replicate the French success throughout Europe, some say he could be destined for the top job at the fast-food firm's head office in Oakbrook, Illinois. After all, Mr Cantalupo only agreed to come out of retirement to help get the firm back on track. And France has shown it can be done.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Advertising and television

A farewell to ads?

Apr 15th 2004
From The Economist print edition

Personal video recorders should worry the big media firms

IF YOU are a senior executive at a media company, you may feel that your industry is built on shaky ground. First, there was digital piracy, which could yet wipe out great chunks of revenue. Now there is the personal video recorder (PVR), which allows people to watch TV programmes whenever they like more easily and, crucially, to skip rapidly through all the commercials. While the pirates can be chased, the PVR is more difficult to come to terms with, not least because powerful media groups like News Corporation, Rupert Murdoch's empire, and Time Warner, a conglomerate, are busily pushing them.

Fear of PVRS has stalked the industry since they appeared in 1999, but until now there have been relatively few users. In America they are in about 3.5m homes. In Britain, BSkyB, a satellite-TV company controlled by Mr Murdoch, expects that just over 300,000 homes will have them by June as part of its "Sky+" pay-TV package.

Such promotions mean the use of PVRs will grow rapidly. The reason? Satellite companies think the machines will help them compete with cable TV's video-on-demand services. In turn, cable needs to compete with satellite. Both are selling PVRs cheaply—and in some cases giving them away. Customers tend to stay loyal to one provider once they have a PVR. And people who use them love the control and convenience they bring to viewing. By 2006, says Forrester, a research firm, nearly 25m American homes will have PVRs.

What people do with their PVRs is exactly what advertising executives had feared. A study by TiVo, an American provider of the machines, found viewers watch recorded programmes 75% of the time and skip about 60% of commercials. According to the *New York Times*, a new survey by Yankelovich Partners, a market research firm, will show most people resent the quantity of advertising and marketing aimed at them. Some 70% said that they would be interested in products and services that help them to skip or block it out. They can do that with video-cassette recorders, but in practice people find them fiddly to use. With built-in electronic programme guides, PVRs make recording easy—with no need to set timers or buy cassettes. By 2007, Forrester expects TV commercials to be watched at least 15% less than they are now. The decline will be steeper if PVRs end up in most homes.

As more people skip past their ads, advertisers will refuse to pay what they now do for TV spots. A 20% drop in TV advertising in 2003 would have cut profits by one-third at Disney and Viacom, which each own broadcast networks and stations, according to Tom Wolzien of Sanford Bernstein, an investment company. The home entertainment bit of the media industry also frets about PVRs. Because their owners can select what they want from a whole week's TV viewing, they are no longer at the mercy of schedulers, so they might buy fewer DVDs.

For now, few top media or advertising executives will admit publicly that there is a big problem coming. The ad-avoidance numbers for early adopters are arresting, concedes Irwin Gotlieb, chief executive of Group M, a media buyer which is part of the WPP advertising group. But he says the mass market will be far happier to sit back and passively consume what is put in front of them, as they do now. Besides, people already skip ads by leaving the room, channel surfing and so on: PVRs will make ad-avoidance more obvious and measurable, but little will really change. Another, rather desperate, hope expressed by some, is that consumers will be exposed to advertising even when fast-forwarding because they have to watch in order to pick the right spot to hit "play".

The world's big advertising agencies are bound to underestimate the impact of PVRs, says Mark Ritson, a marketing expert at the London Business School. The agencies are "introverted and arrogant" organisations, he says, which find it hard to understand that many people dislike commercials. Much will

depend on when big marketers such as Unilever and Ford figure out what is going on. That would require good data on PVR use. Nielsen, America's dominant TV-ratings firm, which profits from buoyant TV advertising, recently announced that it would start to monitor PVRs in 2005—but not in enough detail to show ad-skipping.

Glenn Britt, chief executive of Time Warner Cable, argues that, if PVRs do make a big impact, the media industry should adjust its business model. Most obviously, it could put more emphasis on print, radio and the internet, where people can also ignore ads but not always so obviously and measurably. One hope is that PVRs will allow firms to learn more about viewers so that they can be sent advertising that is appropriate to them: media firms will sell less airtime, but charge more for it. To stop people hitting the fast-forward button, says Sir Martin Sorrell, boss of WPP, advertising will need to become more creative, powerful and informative.

There are all sorts of devious ways to get through even to hardened commercial-skippers—advertisers already use product placement within films and TV shows, for instance. Sponsorship slots at the start of a programme (when fingers come off the fast-forward button) will matter more. The value of live TV—news and sport—will rise. BSkyB has also found that people with PVRs watch 20% more TV each week. Presumably, as they can select with their PVR the best from the schedule, their satisfaction with what they watch is higher too.

But if media firms cannot find creative new ways to sustain their television ad revenues, they will simply have to charge consumers more for programming. Rising subscriptions could make viewers think more kindly of commercials—especially if they were to be charged less for programmes if they agreed to sit through ads. With all the potential benefits that PVRs can provide for viewers, the entertainment industry is going to have to learn how to live with them—one way or another.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Confectionery

Creaming it

Apr 15th 2004 | NEW YORK
From The Economist print edition

A Japanese chain selling cream puffs is an international success

AFTER Uniqlo, an urban-chic clothing store, Japan has another global retailing hit on its hands—in the unlikely form of cream puffs. Beard Papa's, a subsidiary of Muginoho, an Osaka-based restaurant chain, opened its first store outside Asia last month on Manhattan's Upper West Side. The queues snaking down Broadway are startling in a neighbourhood that generally eschews trendy eateries for trusty favourites like Fairway's deli and Big Nick's diner.

In the last year, Beard Papa's, named after Yuji Hirota, the older of its two founders and with a logo that combines Popeye and Santa Claus, has started to conquer Asia with a simple concept: in imitation of a factory assembly line, its staff bake choux-pastry shells and fill them with semi-sweet custard cream in front of customers. In addition to opening 240 outlets in Japan, Beard Papa's last year clocked up an impressive ¥15 billion ($138m) in sales. Barely seven years old, it has some 40 franchises in Asia.

And like all good ideas, it has already been imitated, with some 30 copycat chains in Japan and a failed one in South Korea called Beard Uncle. Potential franchisees are queuing up in Australia and New Zealand.

So it was courageous for Beard Papa's to choose Manhattan as its western test-bed. New Yorkers lack the expanded waistlines of much of middle America—though Krispy Kreme donuts do surprisingly well there. But Jimura Takuji, vice-president of Muginoho USA, says its New York shop, which sells up to 5,000 puffs a day at $1.25 each, is already profitable and will branch out from vanilla fillings to more adventurous flavours like green tea. He claims Beard Papa's strikes an admirable compromise at a time when people are watching their weight, but still hunger for the odd treat. “Krispy Kremes are oily and unhealthy. Our cream puffs are natural, not too sweet,” he claims, echoing the chain's boast that it only uses fresh ingredients—like vanilla pods from Madagascar—and that its puffs are baked not fried. But donut wars could yet break out. This week, Krispy Kreme said it was considering entering the Japanese market. Beard Papa's, meanwhile, proves that while entrepreneurs in Japan may come in bite-sized portions, they do exist.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Music and mobile phones

Ringing the changes

Apr 15th 2004
From The Economist print edition

Could mobile-phone ringtones spawn a new music market?

Get article background

Alamy

Britney ringing

DOWNLOADING a special ringtone on to your mobile phone—so that it plays a tinny rendition of a pop song instead of ringing—is a booming market. Ringtone sales were $3.5 billion worldwide last year, up by 40% from 2002, according to ARC Group, a consultancy. Europe and Asia lead the way, but in America the Yankee Group, another consultancy, recently raised its estimate of last year's ringtone sales from $50m to $80m. Sales of ringtones, costing up to $4 each, have now overtaken those of CD singles. Many artists now make more money from the former than the latter. Ringtone sales also outstrip legal internet download services, such as Apple's iTunes, which generate under $100m a year worldwide.

The appeal of ringtones, to teenagers in particular, is that they act as a fashion statement. Sound quality is improving fast: newer phones support polyphonic playback and the latest handsets allow actual music clips, called “true tones”, to be used as ringtones. Instead of a plinky-plonk rendition of the Britney Spears hit, “Toxic”, as your ringtone, you could have a brief sound clip of Britney herself.

Both mobile operators and record labels sense a huge opportunity here. Anyone can make a ringtone out of a pop song, provided they pay royalties. But true tones require the record labels to license the master recording. They will only do so to trusted partners, such as mobile-networks. The dubious firms that currently dominate the ringtone business (many of which began life as providers of porn phone lines) may be squeezed out. Already in America, Verizon Wireless has partnered with BMG and EMI. In Europe, T-Mobile is collaborating with Universal and Sony.

The success of true tones would give record labels and operators a larger slice of the market. Will it also spawn an entirely new, far bigger, market for mobile-music downloads? It is not a big leap to downloading a whole song for playback through headphones. Within a couple of years, as fast new 3G networks are switched on, mobile phones get smarter and music-playback more common, there may be a thriving market in music downloads to handsets that are also personal jukeboxes. Martin Fabel, an analyst at A.T. Kearney, says mobile downloads could account for 20-30% of music sales by 2006.

This is music to the ears of record companies and mobile operators. Mobile-music downloads, they hope, will command a “mobile premium” over fixed-line services such as iTunes, which charges $0.99 per song. But this will only succeed with agreement on sensible pricing and revenue sharing, says Ian James of Chrysalis Mobile, a firm that hopes to be a “trusted intermediary” for ringtones and other music content. “If we can get everyone in the value chain happy, there's a potential opportunity for a much broader market than the current singles market,” he says, since it would allow mobile subscribers to buy music on impulse, wherever they are. Having nearly killed the market for singles, mobile ringtones could yet revitalise it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Vietnam's oil

Petro folly

Apr 15th 2004 | HANOI
From The Economist print edition

How not to build a refinery

THE government of Vietnam, although nominally communist, has warmed towards free enterprise. Like its counterpart in China, it has legalised private firms, courted foreign investment and even admitted businessmen to the Communist Party. But as much as it welcomes the jobs and tax revenues that private businesses bring, it cannot seem to wean itself off a ruinous addiction to inefficient state-owned firms. Businessmen complain that giant public firms still hoover up and squander the lion's share of loans, depriving better-run companies of capital needed to grow.

On that score, one of the biggest offenders must surely be PetroVietnam, a state-owned oil firm which is moving into refining in a big, expensive and hare-brained way. PetroVietnam is already building a refinery at Dung Quat, on the central coast, at a projected cost of $1.3 billion, and wants to build another, in Thanh Hoa province, a little further north, for $2.5 billion.

The one at Dung Quat was originally scheduled to start work in 2000, but construction is still in the preliminary stages. Foreign oil firms promised to invest in the new refinery, but have since pulled out. The latest to do so, Russia's Zarubezhneft, dropped out in 2002. PetroVietnam now says it will press ahead alone, although the World Bank, a big lender to Vietnam, has long argued that the project should be scrapped.

A recent report for the United Nations development programme explains the basic problem: over-capacity and thus razor-thin margins. David Dapice, the author, calculates that in the past five years, Vietnam has paid only $11 more per tonne for imported refined products than it has earned from exports of crude oil. So Dung Quat's projected annual output, of 6.5m tonnes, will be worth only $72m above the price of the oil used in its products. But Professor Dapice estimates running costs and interest on its loans will add up to around $200m a year. In other words, refining oil at Dung Quat will actually cost $130m more each year than simply importing the same stuff. Vietnamese consumers and taxpayers will presumably pick up the tab, while Vietnamese businesses will miss out on $1.3 billion in loans.

To make matters worse, PetroVietnam is building the refinery in the wrong place for political reasons. The oil comes from offshore fields in the south. The bulk of Vietnam's population and industry—the future customers—are in the southern, and to a lesser extent the northern, extremes of the country. But the politicians worry that the area in between is missing out. So, in true communist style, they ordered PetroVietnam to build the refinery there to stimulate the local economy. PetroVietnam is said to be protesting the decision, but so far the politicians will not budge.

Corruption will probably also increase the price tag. Last May, two senior executives at PetroVietnam were sacked due to “irregularities” in the construction contracts for Dung Quat. Soon afterwards, the government reorganised the hierarchy to strengthen oversight of the project. But in its typically opaque style, it refused to explain exactly what had gone wrong.

Vietnam introduced a liberal companies law in 2000, and in the next three years 54,000 private businesses sprang up, creating 1.75m new jobs. State firms contributed almost no new jobs at all, but received 56% of all investment over the same period. White elephants like Dung Quat look likely to crowd out worthier private projects for years to come. The only good thing that can be said about them is that they demonstrate the folly of allowing bureaucrats to play businessmen.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Executive compensation

A better option

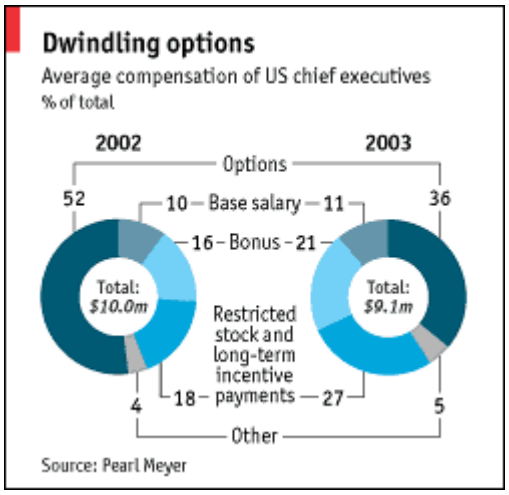
Apr 15th 2004
From The Economist print edition

How top pay is changing and might change more

Get article background

EVERYONE knows that it is not much fun sitting on a corporate board's audit committee, but up to now the compensation committee has been a more comfortable billet. That is changing. Meetings and the time demands on members have doubled in the past few years, says Steven Hall of Pearl Meyer, an American pay consultancy. The reason? Shareholders have woken up to the perverse effects on executive behaviour of corporate pay, and especially of stock options, and want to see pay more directly linked to performance.

The main change so far has been a shift away from stock options, especially as a way to reward chief executives, and towards bonuses and restricted stock (see chart). A survey by Pearl Meyer of the proxies of 180 companies with the same boss in 2002 and 2003 found that overall compensation dropped from an average of $10m to $9.1m. Within both totals, base salary is a tiny amount: 10% in the first year, 11% in the second. But the big change is a drop in the proportion of pay delivered through stock options to the lowest level in seven years.



It is not just shareholders who are disillusioned with stock options. Plenty of employees are too. At the end of 2002, after almost three years of falling share prices, more than half of all stock options were underwater. But even at the peak of the bull market, in 1999, reckons Brian Hall of the Harvard Business School, roughly one-third of options were underwater. And even when options are not drowning, employees see their value as less than the cost a company incurs to provide them. The complexity of options and the limits on exercising them mean that employees do not value them as highly as the complicated Black-Scholes valuation does.

Now there is a chance for change. From the end of this year, companies are unlikely to be able to grant options without incurring any accounting charge. Instead, they will have to charge the cost of options on their income statements. So companies have an incentive to think again about how they reward good performance.

Many have already switched to “restricted stock”—shares that executives get if they meet certain performance targets. The biggest switcher has been Microsoft, previously the world's largest user of options. After four years of a declining stock price and miserable employees, Microsoft last year offered its staff an ingenious way to dispose of their options, with the help of J.P. Morgan, an investment bank. Now the bank and Mr Hall both think that Microsoft's model may be a better alternative to options than restricted stock.

Microsoft offered its employees a one-off chance to sell their options to J.P. Morgan. Some 51% of eligible employees did so. The bank had spent two and a half years creating the scheme, ensuring that the Securities and Exchange Commission approved of it and working out the tax details. It hopes that other companies will see that transferable stock options (TSOs) have advantages over both ordinary options and restricted stock.

Mr Hall agrees. When the market is booming, TSOs have the powerful leverage of ordinary options, which

pay out only if the share price rises above a certain point, whereas restricted stock is worth something at any level. But, if the market tanks, options are valueless. TSOs still have some value (though less than that of restricted stock), because they can be sold, even if at a knock-down price.

Moreover, the price at which they change hands provides a more accurate picture of their value than the complex Black-Scholes formula. And the price may well be higher than the value employees would place on the options if they were not transferable. “The crucially large gap between the employee value and the company cost of underwater options makes it possible for shareholders and employees to cut a deal that makes both sides better off,” says Mr Hall.

Above all, a secondary market makes options more transparent. Investors and employees can see what they are worth. Will they catch on? J.P. Morgan says that several companies have put into their 2004 proxies language that would allow them to use TSOs. None has yet announced plans to do so. Most, says the bank, are waiting for mandatory expensing to start.

Others are more doubtful. “TSOs haven't been a live issue,” says Pearl Meyer's Mr Hall, “and as the stockmarket gets stronger, the incentive will go.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Face value

Getting Africa moving

Apr 15th 2004
From The Economist print edition

Will Maria Ramos dare free-up the transport monopoly that retards South Africa's economic growth?

IT IS a short drive on a congested road from Pretoria, South Africa's political capital, to Johannesburg, its commercial one. But Maria Ramos, who just moved her office from the former to the latter, has a much longer and more difficult path ahead of her. Last year she quit as head of the Treasury in Pretoria, after more than seven years working closely with Trevor Manuel, the finance minister. Together they deserve much of the credit for the broad macro-reform of South Africa's economy: cutting debt, subsidies and inflation, and boosting exports. Now, as boss of Transnet, the state transport monopoly with fixed assets of 70 billion rand ($11 billion), she finally has the chance to tackle some of the biggest micro-level obstacles to raising the rate of growth of the country's GDP from an average of 2.8% a year at which it seems stuck.

From her 50-floor building in downtown Johannesburg, Ms Ramos must quickly find ways to kick-start creaking rail services, unblock overwhelmed ports and relieve a debt-laden airline. It is an unenviable task, and one so controversial that she has to be careful about what she says while this week's general election is under way in South Africa.

Transnet is a giant by African standards. It runs freight, passenger and commuter trains, it transports petrol and gas, and it operates and owns ports and vast amounts of property and—indirectly—the national airline, South African Airways (SAA). Transnet already has stakes in more than 20 other countries, mostly through rail subsidiaries or in management deals in Africa, and is likely to spread much further across the continent.

But the giant is tottering. Its turnover of 41 billion rand and profit of 5 billion rand for last year are not too bad at first glance, though the monopoly could expect to rake in even more. However, high levels of debt hamper the group: Transnet as a whole owes 32 billion rand. SAA ran up a 6-billion-rand loss in the past couple of years by losing a hedging bet against the currency. The group's hopeless pension fund (already bailed out once by the government) has blown another 8 billion rand in four years, and is in debt by 6 billion rand. To help plug that gap the government said on April 5th it would hand over 2.5 billion rand of proceeds from the sale of its share in a cell-phone firm, MTN.

All that is bad enough, but prospects of improvement are bleak without hefty new investment. More than 80 billion rand of spending is needed in the next 15 years, says Ms Ramos, about half of it on the slow,

overloaded and unreliable rail network. New locomotives, wagons, rails and lines are all needed.

In her Treasury job, Ms Ramos encouraged fast expansion of exports. Overseas sales of cars, catalytic converters, iron, steel, coal, gold and other exports are steadily rising; but they are all stuck in a tightening bottleneck. Coal producers want to shift more than their existing 95m tonnes by train each year, but the rail system cannot cope. The country's ports, especially the biggest in Durban, are notorious for costly delays. Some investors talk darkly of going elsewhere if the transport mess is not sorted out. Iscor, a steelmaker, as well as car exporters such as Toyota and BMW, say they might ditch South Africa's trains all together, or swap to rival ports in Mozambique or Namibia.

Hard to do

Ms Ramos knows better than to go cap in hand to her old employer in search of more state funds. She said in March that Transnet must cut costs, not least by losing some of its 76,000 employees, especially from the overstaffed head office. But it will take guts for a leading member of the African National Congress, the party which runs the government with trade union and communist allies, to sack people fast.

Ms Ramos also wants more private investment, through joint-ventures and by selling off “non-core assets”. Talk of privatisation does not go down well with voters, but she thinks some freight business, an internal communications firm and the Blue Train (a luxury tourist service) could be sold. But why not put the bigger and more lucrative parts up for sale too?

More details may be announced after the election. SAA, Africa's largest and most successful airline, is expanding rapidly and would be tempting for investors. A fifth of the airline was sold for 1.4 billion rand in 1999 to Swissair, but bought back for a bargain 382m rand when the Swiss airline went bankrupt. If the country's ports were privatised, they also might be better able to expand to meet exporters' needs. A British firm runs Maputo harbour in Mozambique, which is rapidly beginning to rival Durban. Portuguese-born Ms Ramos told a local financial magazine in March that Transnet's monopoly-happy managers have behaved for too long as if no rivals would appear. Incompetence and high fees at Spoornet, the rail firm, are chasing business on to roads instead. Private owners of the rail firm would be less likely to behave that way.

But privatisation is painfully slow in South Africa. Though new investments, such as privately run and excellent toll-roads, have proved successful, Ms Ramos's political allies are wary of moving fast. She talks of wanting an integrated company able to ship everything from harbour or airport to city. In fact, it would probably be far better if she could inject competition into transport by breaking up monopolies. Privatisation could also raise cash for new investments—such as suburban commuter trains—that would be unlikely to attract private investors.

Can Ms Ramos expect progress? In one area, at least. Next year work begins on the Gautrain, a high-speed rail link for Pretoria, Johannesburg and the international airport. Its success depends on private builders and operators, and on finding ways to tempt commuters from their cars. It could be a model for the rest of the rail network. Ms Ramos, as she shuttles between the two cities, has to lead the way.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Wal-Mart

How big can it grow?

Apr 15th 2004 | FRANKFURT, LONDON AND VALLEY OF THE SUN, ARIZONA
From The Economist print edition

AP

The world's biggest retailer is defying its critics by continuing to grow vigorously

Get article background

AT A recent retail-industry convention, Wal-Mart's boss, Lee Scott, was asked whether his firm was trying to take over the world. “I don't think so,” Mr Scott replied with a smile on his face. “All we want to do is grow.”

How big can Wal-Mart grow? With $256 billion in sales in the year to January 31st, the firm is already the world's biggest company by that measure. Its nearest retailing rival, a French supermarket chain called Carrefour, is less than half Wal-Mart's size. In America, Wal-Mart manages nearly 3,000 giant discount stores and hypermarket “supercentres”. Abroad, it has ventured into Mexico, Britain, Japan, Canada, Germany and China, as well as making smaller investments elsewhere. Eight out of ten American households shop at Wal-Mart at least once a year. Worldwide, more than 100m customers visit Wal-Mart stores every week. Photographs circulated over the internet and purporting to come from the *Exploration Rover* show NASA's recent discovery of a Wal-Mart on Mars.

The mathematics of big numbers suggests that Wal-Mart's growth must slow. Amazingly, the opposite appears to be happening. In America this year, Wal-Mart intends to open some 50 new discount stores and more than 220 new supercentres, some of which will be existing stores moving to new locations. Overseas, it plans another 140 or so new stores, including relocations. This adds up to some 50m square feet of new space—even more than many of its rivals operate in total.

As Mr Scott likes to points out, Wal-Mart still represents “only” 8% of total retail sales in America. It is not unusual for dominant firms in mature industries to command market shares of 30% or more. So, in theory at least, Wal-Mart could still get an awfully lot bigger.

Although the firm possesses undeniable momentum at the moment, its sustained smooth expansion is by no means inevitable. Wal-Mart's success is sharpening the acts of other retailers, some of whom are learning how to compete more effectively against the “Beast of Bentonville” (Wal-Mart's headquarters are in Bentonville, Arkansas). Legal and labour problems threaten the firm's decentralised, entrepreneurial culture—a culture which, until now, Wal-Mart has zealously protected against creeping corporate bureaucracy. Abroad, the firm's success remains in doubt, as does its ability to make money out of new

retail formats at home. Most important of all is the likely future growth of its core domestic discount-store business, which makes up 65% of the firm's sales and 87% of its profits. When will that begin to slow?

One of the guiding principles of Sam Walton, the company's late founder, is to pass on savings won from suppliers to consumers, which encourages more of them to shop at the company's stores and to buy more things. Wal-Mart then profits from higher sales, instead of simply putting the savings directly into its coffers. The company is skilled at obtaining products cheaply, and the emergence of China as a centre of low-cost production is playing to its strengths. Wal-Mart already buys $7.5 billion-worth of goods directly from China each year and another $7.5 billion via its suppliers, with scope for more in future. Shoppers make such big savings that economists credit Wal-Mart with driving down America's inflation rate.

This strategy of “Always Low Prices. Always” continues to surprise even Wal-Mart with its success. When Tom Schoewe joined the firm as its chief financial officer four years ago, Wal-Mart thought that its core discount-store business was about to slow, he says. The company began looking for other sources of growth by investing more heavily in different formats: smaller groceries, called neighbourhood markets, that were meant to fill in the spaces between the larger discount stores and supercentres, and a warehouse-style format, which Wal-Mart calls Sam's Club. But, says Mr Schoewe, Wal-Mart then changed tack. It began to realise that America's suburbs can absorb many more supercentres than the company had previously supposed.

Glorious suburbia

If that seems fanciful, then spend the 45 minutes it takes to drive across Arizona's Valley of the Sun from Scottsdale, a well-heeled suburb of Phoenix, to the city of Surprise to the west. Between the strip malls, low-rise apartments and Whataburger franchises that dot the route, Wal-Mart's name pops up again and again. On a single 20-mile stretch of road sit six giant Wal-Marts, all of them doing a reasonable business on a recent rainy weekday. Shoppers have 14 more Wal-Marts to pick from a few miles further south and east. The area, says Mr Schoewe, with obvious pride, “shows you what can happen.”

The valley's sprawl—the Phoenix area has annexed 400 square miles of desert in the past 50 years—suits Wal-Mart perfectly. In other bits of America, the firm is finding growth more difficult. Some communities (notably in California and the north-east) oppose yet more supermarkets and edge-of-town hypermarkets. There are plenty of Americans who accuse the so-called “big-box” retailers of driving local firms out of business. In prickly California, Wal-Mart has tried to bypass planning committees by appealing directly to voters, so far without success. On April 6th, 60% of voters in a local referendum in Inglewood, a suburb of Los Angeles, turned down a proposal for a giant new Wal-Mart.

Some of Wal-Mart's new supercentres, which can range up to 220,000 square feet in size, are now being designed to be just a fraction smaller than the 100,000 square-foot limits on retail units that have been imposed in some parts of America. For instance, Wal-Mart recently opened a 99,000 square-foot outlet in Florida.

In states with strong trade unions, such as New Jersey, Illinois and California, Wal-Mart has faced what has been called an “invisible picket line”: obstruction and boycotts, sometimes only on an individual basis, by people who object to its strong anti-union stance. Naturally, Wal-Mart has grown fastest where it has been easiest to build its big boxes. Per head of population, there are between five and ten times as many stores in Arkansas, Oklahoma, Mississippi and Missouri as there are in New Jersey, California and New York.

Wal-Mart is buying up land at an astonishing rate. The monthly real-estate meeting in Bentonville approves more than $1 billion-worth of land purchases every time it gathers, says Mr Schoewe. Yet as Wal-Mart makes more of those purchases in the less-served, but more difficult states, growth will inevitably slow. It can take the company two or even three times as long to open an outlet in California than in Arizona, for instance. All the same, Michael Silverstein of the Boston Consulting Group (BCG), thinks Wal-Mart's core business has three years of decent growth left in it. Darrell Rigby of Bain, another consultancy, thinks there is “plenty of room at least through 2010.”

That growth alone would result in a firm with annual sales of somewhere between $350 billion and $450 billion. On top of this, investors must weigh the likely success of Wal-Mart's expansion overseas where, in the longer term, the firm will have to find the bulk of its growth. Traditionally, retailers are not very good at going abroad. Wal-Mart is no exception. It has done well in America's border countries. It has been successful in Canada, for instance, and in Mexico, where Wal-Mart is the biggest private employer.

But in Germany, Wal-Mart ended up with egg on its face. Even Mr Scott has admitted that the company's arrival was “somewhat embarrassing”, although the situation is improving. Wal-Mart entered Germany, the third-biggest retail market after America and Japan, in 1997-98 by buying two local retail chains, Wertkauf and Interspar, for $1.6 billion. Whereas Wertkauf was well-known and profitable, Interspar was weak and operated mostly run-down stores. Wal-Mart has lost money in Germany ever since. Problems have included price controls, which prevent below-cost selling, rigid labour laws and tough zoning regulations, which make it extremely difficult to build big stores.

Wal-Mart also faced well-established rivals in Germany, like Metro, and hard discounters such as Aldi and Lidl, already comfortable with razor-thin profit margins. Many retailers in Germany are owned by wealthy families whose business priorities are not always the maximisation of shareholder value.

But there was more to it than that. Wal-Mart's entry was “nothing short of a fiasco”, according to the authors of a study at the University of Bremen. At first, Wal-Mart's expatriate managers suffered from a massive clash of cultures, which was not helped by their refusal to learn to speak German. The company has come to be seen as an unattractive one to work for, adds the study. In part this is because of relatively low pay and an ultra-frugal policy on managers' business expenses.

This contrasts with Wal-Mart's much smoother expansion into Britain, where it bought Asda for $10.7 billion in 1999. Asda already had a strong business competing on price, and it has since overtaken struggling J. Sainsbury to become the second-biggest supermarket chain after Tesco. But that may say more about Sainsbury's difficulties in overcoming its problems than Asda's successes. Unlike Tesco, under its boss Sir Terry Leahy, Sainsbury was slow in responding to Wal-Mart's expected arrival in the British market. In particular, it was late in expanding into non-food goods, the source of much of Tesco's growth. Tesco, which now has half its retail space overseas, also competes with Wal-Mart in other countries.

A force for good?

In the popular imagination, Wal-Mart ruthlessly exterminates the competition, especially local mom-and-pop retailers. Yet as Bain's Mr Rigby argues, Wal-Mart is more than just a destructive force. “Wal-Mart is good for retailing in the same way that any good predator is good for an ecology,” says Mr Rigby. “Life works through struggle, and many retailers are better today because of Wal-Mart.”

A number of retailers in America have gone up against Wal-Mart and survived—even thrived. They have deliberately avoided trying to do the same thing as Wal-Mart. Hence Target, based in Minneapolis, competes as a sort of “upmarket” Wal-Mart with low prices, but a more edited selection of goods. It also employs its own designers to create exclusive ranges. Costco, based in Issaquah, Washington state, operates a chain of membership discount-warehouses, which rival Wal-Mart's Sam's Club chain. Costco carries international brands and is particularly noted for its wines and surprises: it recently had $52,000 diamond rings for sale. Costco also has a reputation for paying its staff well above the average union

rates.

Then there is HEB, a 100-year-old retailer operating supermarkets in Texas and Mexico. It looked to be doomed when Wal-Mart rode into town. But it was re-invigorated into an award-winning grocer that impresses many in the industry. “They looked to where they had an advantage,” says Mr Rigby. “They are, like Wal-Mart, an everyday low-price grocer. But you don't have to match prices on everything.” One of HEB's features is a concept called “Central Market” which provides a wide variety of fresh and prepared foods within its stores, including on-site chefs who show how to prepare the evening meal.

All three of these retailers offer something similar: low prices, with something extra on top, be it a nicer shopping experience or luxury goods. Conceivably, this might hint at a more threatening market change: that shoppers might begin to tire of the attractions of rock-bottom prices alone. BCG's Mr Silverstein has written a book* describing how American shoppers are becoming increasingly sophisticated in the way they discriminate between “trading up” to those goods they think of as luxury items, and “trading down” to the rest. “Costco does trading up and trading down under one roof,” says Mr Silverstein. “Wal-Mart just does trading down. At some point, that will have played out.”

AP

Growing up with Wal-Mart

Alternatively, the everyday-low-price pull may lessen as prices stop falling so quickly. Mr Schoewe says that, because Wal-Mart has already gained most of the advantages of importing goods from China, deflation in the Wal-Mart economy should slow down in coming years. He maintains that this will be a source of future financial growth for the company. But perhaps slowing deflation will work in the opposite direction, as consumers no longer stampede with such relish through Wal-Mart's stores in search of the DVD player that has dropped from $49 to $28.

Perhaps Wal-Mart might even begin to suffer upward pressure on prices as it struggles to hold down costs. A.T. Kearney, a consultancy, recently examined the perception that Wal-Mart uses its huge size to clobber its suppliers into providing lower prices, but concluded that this is “not a significant source of cost advantage”. Indeed, in many cases manufacturers actually make more money selling through Wal-Mart than through other retailers. Wal-Mart is not easy to work for, but some suppliers say the experience has made them leaner and fitter. One of the latest companies to conclude that it would be better off supplying Wal-Mart is Levi Strauss. It has been struggling to boost sales through traditional department stores, but has now produced a range of jeans, called Levi Strauss Signature, for sale through Wal-Mart and other discount stores. Some are selling in Arizona for $9 a pair. So far, the decision seems to be paying off. This week Levi reported a better-than-expected 9.7% increase in first-quarter sales.

According to A.T. Kearney, Wal-Mart's three-biggest sources of cost advantage are low corporate overheads, the efficiencies of its supply-chain and, above all, its low labour costs. A newly hired “associate”, as Wal-Mart calls its employees, could earn as little as $8 an hour, some 20-30% less than unionised workers at rival supermarkets. Union members might also have benefits, such as health-care insurance.

There are several reasons to suppose that this labour-cost advantage might begin to erode. One is falling costs elsewhere as Wal-Mart squeezes its competition. In February, for instance, unionised grocery-store workers in southern California agreed to wage and benefit reductions following a five-month-long strike. This strike began after local supermarkets proposed to cut wages and benefits in preparation for Wal-Mart's entry into the market.

A second reason might be slowing staff turnover at Wal-Mart itself, as the firm struggles to renew its 1.4m-strong workforce. In recent years, staff turnover at Wal-Mart has fallen from over 60% to 44%, close to industry averages. Yet even with a turnover rate of 44%, the firm has to hire an astonishing 600,000 people every year simply to stay at its current size. As the company grows and employs yet more people, that task will become even more difficult, suggesting that Wal-Mart will want to push turnover lower still. That might put pressure on costs, as workers gain tenure, pay rises and better benefits.

Another force working to slow Wal-Mart down is the company's mounting legal and labour-compliance problems. At any moment, Wal-Mart faces about 8,000 lawsuits. The vast majority of these are personal-injury claims from employees. More material, given the sheer numbers of people that Wal-Mart employs, are employee suits seeking class-action status. Among other suits, Wal-Mart's most recent annual report lists 33 putative class-action suits alleging violations of the Fair Labour Standards Act, including forcing employees to work “off the clock” and failing to provide work breaks; eight further putative suits alleging that the firm failed to pay overtime; and a suit that could prove costly alleging discrimination against its female employees. The potential size of this class alone is 1.5m plaintiffs.

Cleaning up its act

An investigation is also continuing into allegations over whether Wal-Mart knew that a subcontractor was using illegal workers. Last year, federal agents raided a number of stores and took documents from the company's headquarters. Wal-Mart has denied doing anything wrong.

In response to a comment by Mr Scott that “my mornings start with reading sales, followed by a visit from our general counsel,” Forrester, a research company, predicted that “Wal-Mart will spend more legal energy than other retailers as it battles a barrage of lawsuits and struggles to not get distracted by any more legal issues in 2004.” The company is recruiting more legal help: in January, it hired Tom Gean, a former United States attorney, to work with its “operation compliance groups”, which have been set up to assist store managers keep within laws and regulations.

That points to a broader worry for the company: that its cherished entrepreneurial culture might become choked by expanding human-resources, public relations and legal departments. Wal-Mart has fought hard to preserve its entrepreneurial culture, which pushes responsibility out to the company's powerful store managers and endeavours to check central, bureaucratic growth. But being big makes companies a magnet for social issues. And freedom among the firm's store managers to set policies which they think will make their outlets as profitable as possible also provides room for abuse.

With so many eyes watching it, Wal-Mart may have decided that it has to sacrifice a bit of its entrepreneurialism to reduce its legal risks. It recently set up a “reputation taskforce”, introduced new personnel procedures, hired extra lobbyists in Washington, DC, created an “office of diversity”, and launched new public-relations and advertising initiatives, dubbed “good jobs” and “good works”, featuring lots of beaming associates. These are not the actions of a company intending to get smaller. Wal-Mart, already huge, is preparing to get a whole lot bigger.

---

*"Trading Up: The New American Luxury", by Michael Silverstein and Neil Fiske. Portfolio Press, 2003.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China's economy

The temperature is rising

Apr 15th 2004 | BEIJING
From The Economist print edition

ImageChina

China's economy will overheat unless the central bank regains control of the money supply

Get article background

"HOW high are Chinese interest rates?" your correspondent enquired. Unsure of the answer, and a bit embarrassed, the man flicked through a fat statistical report. This was surprising in one way, since the man in question was a senior official of the People's Bank of China, the country's central bank. But it was, perhaps, less surprising in another way, for interest rates play little role in an economy in which credit is allocated with scant regard to its price. And this anecdote demonstrates how hard it will be to cool China's red-hot economy by the means traditional in capitalist economies: charging more for borrowing money.

If China's economy is overheating, that will be hugely important for economic prospects worldwide, because the country has accounted for a quarter of global GDP growth (measured at purchasing power parity) over the past five years. The People's Bank is desperate to slow growth in the money supply and in bank lending. To bring down the latter, on April 11th it announced that it was raising banks' reserve requirements (the deposits they have to hold at the central bank) from 7% to 7.5%—the third increase in eight months.

Official statistics released a few days later explain the central bank's concern. Real GDP growth continued at a breakneck pace of 9.7% in the year to the first quarter of 2004, and consumer-price inflation rose to 3% in the 12 months to March, up from 0.9% a year ago.

Besides increasing banks' reserve requirements, the central bank and the government have also instructed banks to curb new lending to sectors which officials believe are growing too fast, namely steel, cars, cement, aluminium and property. In late March, the People's Bank also raised the interest rate it charges banks. But the rates at which consumers or firms borrow from banks—the key interest rates in free-market economies—have remained fixed for more than two years.

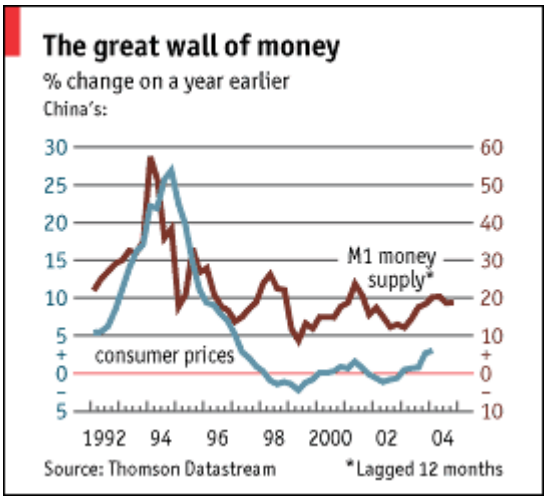
The government line is that the economy is overheating only in this handful of sectors. Yet the figures suggest that it is an economy-wide problem. Bank lending rose by 21% in the year to March. And although the rates of increase in the money supply and bank credit started to slow from the middle of last year, they picked up again in March.

As always, analysis of China's economy is clouded by dreadful statistics. Widely quoted figures show investment 50% higher than a year ago in the first quarter of this year. These figures almost certainly overstate the true pace of growth, and yet more reliable numbers suggest that investment is growing at the still-rapid rate of about 30%.

While that is unsustainable, some perspective is in order. The situation is nowhere near as severe as in 1993-94, when investment grew at an annual rate of over 60%, GDP growth peaked at over 15%, and inflation hit 28%. Nor is China's condition now as fragile as East Asia's economies were in the late 1990s, before the region's economic crisis. Then, excess demand resulted in higher inflation, huge current-account deficits and rampant asset-price inflation. China's inflation is still quite low and it has a current-account surplus, if a shrinking one. Although there may be a bubble in luxury housing, especially in Shanghai, house prices nationwide rose by only 4% on average last year. China's stockmarket has been one of the world's worst performers over the past year.

Although China may not be seriously overheating yet, there are signs that it could do so soon. The main risk of excessive growth is not a surge in inflation, but the inability of China's financial system to allocate capital efficiently. Excessive borrowing is likely to lead to another wave of bad debts. On some estimates, these already amount to 40-50% of all bank loans.

In a developed economy, the obvious solution would be to raise interest rates. But it is a truism of economics that a country cannot control both its exchange rate and its interest rate simultaneously. While the yuan remains pegged to the dollar, the People's Bank can do little about monetary conditions. Huge inflows of capital put upward pressure on the yuan. To hold it down, the central bank must buy foreign currency, which injects new liquidity into the banking system. As a result, banks have excess reserves, undermining the impact of a rise in reserve requirements.



The central bank has tried to mop up the extra liquidity by selling bonds. But such “sterilisation” is getting harder. The central bank has had difficulty selling its bonds in recent months because it needs to sell so many. China's foreign-exchange reserves climbed by 39% in the year to March, to $440 billion, second only to Japan's. Unless investors are offered higher interest rates, they will be reluctant to buy more bonds. But higher interest rates would attract yet more capital inflows.

Chinese puzzle

Though economists hotly debate the question of whether the yuan is undervalued, China needs to adjust its currency, not because it may be too cheap, but to regain control of monetary policy. In the medium term China needs to allow its exchange rate to float. That cannot happen, however, until the banking system is in better shape.

Many foreign economists argue that in the meantime the government should revalue the yuan's peg, widen its trading band or shift from a dollar peg to a basket of currencies. But a modest 5% revaluation of the yuan or a widening in the band within which it is allowed to trade could prove counter-productive. Recent strong capital inflows are driven by higher interest rates in China than in America and by an expected appreciation of the yuan. A small revaluation might thus attract still more capital in expectation of another rise. Any revaluation would need to be large enough—15-20% say—to dash such hopes. Since a rise of this magnitude would be unacceptable to the government, any move is unlikely this year.

Instead, the government may be considering tougher enforcement of capital controls, such as cracking down on the illegal ways in which banks connive with their customers to dodge restrictions on bringing in speculative capital. The *China Economic Quarterly*, an independent newsletter, points to a report published on the website of the State Administration of Foreign Exchange, which details such illegal techniques. This was, it thinks, intended as a warning shot to banks.

Tighter capital controls could allow the People's Bank to raise interest rates. But it is unlikely to be allowed to do so by the government unless inflation goes above 5%. On the other hand, if capital inflows

continue to accelerate, the *China Economic Quarterly* predicts that inflation could be double that by the end of the year. And then the question would not be whether China is growing too quickly, but how fast it will slow down.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hong Kong property

Scaling The Peak

Apr 15th 2004 | HONG KONG
From The Economist print edition

Hong Kong property is making a comeback

Get article background

THE people of Hong Kong are once more indulging in their favourite pastime, which, since money is the life blood of the former British colony, is not demonstrating against Beijing oppression, but punting on local property. Dinner-party conversations have switched from Chinese IPOs—*so* last year—to apartment values. On April 14th a local investor shelled out HK$22,500 ($2,900) a square foot (HK$168m in total) for an "upper penthouse" in Mid-levels, the highest price per square foot since 1996, when a luxury flat in Repulse Bay went for almost HK$30,000 a square foot.

Last month, Pansy Ho, the daughter of Stanley Ho, a local casino tycoon, sold a mansion on The Peak, still the poshest place to live in Hong Kong, for nearly HK$80m—a profit of HK$13m in just six months. And earlier this month, Sun Hung Kai, the territory's biggest developer, paid HK$450m for a villa in Deep Water Bay, the most paid for a house since Hong Kong's property-bubble burst—along with much else in Asia—in 1997. David Eldon, the chairman of HSBC in Asia, has warned that things are getting rather out of hand.

You can see what he is driving at. The number of transactions by so-called "confirmors"—speculators who buy then sell before their first mortgage payment is due—doubled to 300 between February and March, according to Midland Realty, Hong Kong's biggest estate agent. The stock of available properties has dropped from 22,000 last summer to 9,000 now. Demand for offices is soaring. On April 14th local papers reported that Morgan Stanley bought two shopping malls in Kowloon for more than HK$2 billion, the territory's biggest property transaction this year. On the stockmarket, property companies have soared about 90% over the past 12 months.

A bubblet rather than a bubble, perhaps? According to figures from the Land Registry and Midland Realty, the average price of luxury homes and of those for the *hoi polloi* have risen by about half since a trough in the spring of 2003. Though a big jump in less than a year, this recovery follows a deep fall in prices, when a shrinking economy, deflation, rising unemployment and the SARS virus all took their toll. Despite the recent rises, property prices are still half what they were in 1997.

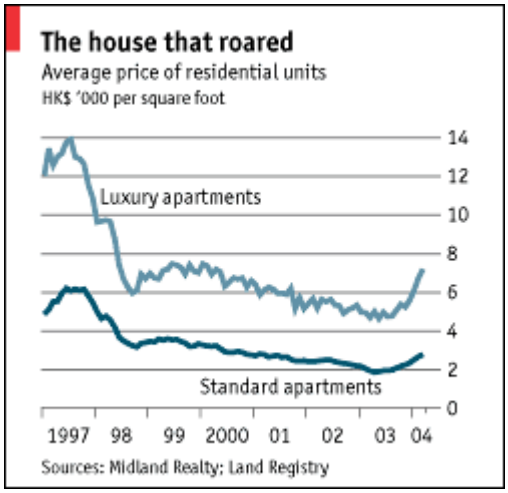
As elsewhere, low interest rates have helped: mortgage rates are at record lows. Simon Lo, the research director at Colliers International, another estate agency, says that mortgage payments currently consume just over a fifth of average household incomes compared with 110% at the 1997 peak—and could comfortably rise to 40%. The question, of course, is whether this comes about via rising property values or rising interest rates.

So far, at least, there are fewer speculators borrowing heavily to play the market. In April 1997, there were 1,835 "confirmor" transactions. Today, many purchases of swankier properties are being made by businessmen—both local and from the mainland—who have profited from China's boom, and by overseas investors taking advantage of the falling Hong Kong dollar. The ordinary buyers are generally those that have scrimped and saved and now want something a bit more spacious. "In 1997, a lot of buyers were short-term punters who barely had enough for the down payment," says Buggle Lau, the chief analyst at Midland Realty.

A measured rise in property prices is good for the economy, since

it will help reverse five years of falling prices, and underpin an upturn in nominal growth. Grace Ng, an economist at Goldman Sachs, forecasts growth in both nominal and real GDP of about 7% this year. Because of transaction taxes and hoped-for sales of government-owned housing, higher property prices will also help close a worrying budget deficit.

Alas, movements in the Hong Kong property market have a habit of being even less measured than they are elsewhere. Local estate agents are forecasting a 20% gain in real estate values this year, but prices have risen that far already, and show few signs of slowing down.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade

Oh, sweet reason

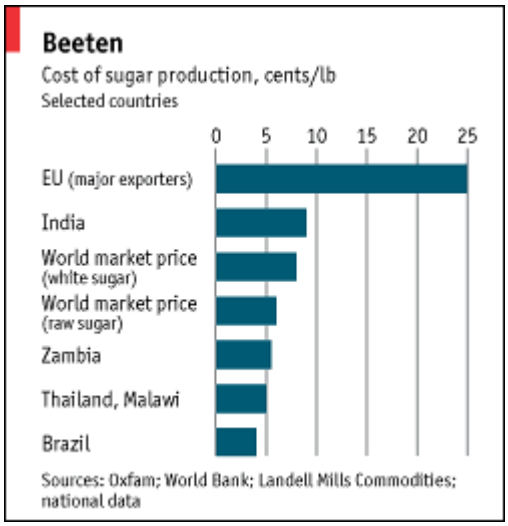
Apr 15th 2004
From The Economist print edition

A report counts the cost of Europe's sugar subsidies on poor countries

AS THE Doha round of trade negotiations slowly revives at the World Trade Organisation (WTO) in Geneva, agricultural subsidies and tariffs have been taking centre stage. A new report from Oxfam, a campaigning group for poor countries, highlights the absurdities of agricultural subsidies, by focusing on those for sugar, a product that developing countries are especially good at producing. In particular, the report explains exactly how the European Union's common agricultural policy (CAP) enriches a few European farmers and sugar refiners at the expense of the world's poorest.

Oddly, the EU is the world's second-biggest sugar exporter. Though it does not have the right climate for growing cane sugar, since Napoleon's time Europeans have grown sugar beet instead. They do not, however, do this efficiently: the cost of producing a pound of sugar in the EU is more than six-times higher than in Brazil, says Oxfam (see chart). It argues that the EU subsidy is much bigger than the €1.3 billion ($1.5 billion) it owns up to publicly. Oxfam says there are €833m of “hidden subsidies”, too.

Subsidising sugar producers is not just economically stupid, it is morally indefensible, too. For Europe's subsidies are not merely a quaint way to keep a few farmers in business. They cause so much sugar to be produced that the stuff is exported to poor countries, hurting farmers who might otherwise earn a living by growing it themselves—and perhaps even exporting it to Europe.



At most, only 1.5m tonnes of sugar a year is bought in Europe from preferred trading relationships with African, Caribbean and Pacific countries. Worse, the sugar provisions of the CAP set poor countries against each other. European subsidies mean that its excess sugar ends up in places such as Algeria, Ghana, Congo and Indonesia, displacing sugar produced in countries such as South Africa and India.

Brazil and Thailand are the hardest hit, Oxfam reckons. On its analysis, Brazil loses around $500m a year, and Thailand about $151m, even though these two countries are the most efficient sugar producers in the world. Even less efficient, and poorer, African countries lose out. Mozambique will lose $38m in 2004—as much as it spends on agriculture and rural development. The costs to Ethiopia equal the sums it spends on HIV/AIDS programmes.

The biggest winners, says Oxfam, are large European sugar refiners. France's Beghin Say, it claims, benefits by €236m a year, Germany's Sudzucker by €201m, and Britain's Tate & Lyle by €158m. Further progress at the WTO may depend in part on whether such firms will accept the loss of such subsidies. That fact should leave a very sour taste in the mouth.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

American pensions

Pension pork

Apr 15th 2004 | NEW YORK
From The Economist print edition

A new law fails to fix—and probably worsens—America's pension problem

IT WAS a happy Easter weekend for corporate America. On April 10th, president Bush signed into law a bill that lets companies reduce the required contributions to their defined-benefit pension plans by more than $80 billion over the next two years. Airlines and steel companies, already the biggest beneficiaries of a temporary bail-out, snared an additional $1.6 billion in extra pension relief. Already wobbly companies will thus continue to make pension promises they cannot keep. If anything, the new law will make a bad problem worse. As one government official says: “It is smoke, mirrors and politics.”

Central to the pension bail-out is the interest rate that is used to measure the present value of a pension plan's obligations. The lower this “discount rate”, the higher the current value of pension liabilities, and the more cash a company must set aside. The new bill lets companies use a much higher discount rate than the one they were using before.

Since the 1980s, the discount rate set by Congress has been based on the 30-year Treasury bond, which the government stopped issuing in 2001. But ballooning pension deficits caused by record-low interest rates and the dismal performance of the stockmarket prompted Congress to pass a bill in 2002 that let firms use a higher rate for a while. But this allowance ran out at the end of last year, and quarterly pension contributions are due from companies on April 15th. Feeble companies were keen to use as high a rate as they could get away with. In an election year, the lobbying power of the weak has been great.

That does not, however, make them right. Many academics argue that the correct discount rate is one based on government bonds, because every corporate defined benefit plan in America is insured by the Pension Benefit Guaranty Corporation (PBGC), a quasi-governmental agency. Companies claimed that this rate was too conservative, and that they should use corporate bonds instead.

Last July, the administration proposed allowing companies to use high-grade corporate bonds, but forcing them to match the maturity of these with the average working life left to their employees. The idea was that firms with older employees should value their (shorter-term) pension obligations with (lower-yielding) shorter-term corporate bonds.

Even this compromise was not enough for the likes of the steel and airline industries. Thus, the new law allows firms to use not only top-notch corporate bonds in their discount rate, but shoddier ones (with higher rates), too. And these bonds would not have to be of the same maturity as their pension liabilities, even when these are shorter, as in the steel industry.

So pension deficits will apparently shrink—but the underlying risk of America's pension system will not. Worse, the law fails to address the root of the problem: that corporate pension plans in America allocate some 60% of their assets to equities, a bad match for annuity-like pension promises. Exacerbating this are convoluted accounting rules that mask the true extent of pension under-funding and a sloppy method of charging PBGC premiums that is not tied to a company's credit rating or the riskiness of its investments.

The result is that, with the knowledge that, *in extremis*, they can dump their pension liabilities on to the PBGC, companies have a huge incentive to pour their money into equities and other risky assets.

Small wonder that, after three years of sponging up the pension deficits of a string of bankrupted companies, the PBGC's finances are a mess. The agency plunged from a $7.7 billion surplus in 2001 to an $11.2 billion deficit in 2003. It reckons that $85 billion of pension deficits are at financially unstable firms. The good news is that the PBGC has enough cash for now. The bad news—as the S&L crisis of the

early 1990s and the mess that is Social Security attest—is that the longer Congress tries to postpone the day of reckoning, the bigger the eventual bill.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Terrorism insurance in America

The buck stops where?

Apr 15th 2004
From The Economist print edition

Insurers are battling to keep government backing for terrorist cover

WHO will pay if America suffers another terrorist attack on the scale of September 11th, or worse? Up to $40 billion is being paid out for all sorts of claims—life, property, business disruption and so forth—following those attacks. Fairly speedy payouts helped America's economy bounce back quickly. Despite the huge losses, insurers coped well and only one smallish reinsurer went bust.

No matter: the industry threatened to withdraw terrorist cover unless the government capped its losses. Thus, in November 2002, Congress passed an act that made the government the insurer of last resort. But the law is due to run out late next year, and insurers want to know what help, if any, they will get from the government for policies that run after that date. They claim that they will be able to write few terrorist policies without it. Lobbyists are out in force.

In return for government backing, insurers are required to offer terrorism cover to businesses, the price of which can be set by state regulators. In the event of a big attack, private insurers must pay a good-sized chunk, up to 15% of their annual premiums. Above that, the government picks up nine-tenths of the costs, to a limit of $100 billion. America's law expires in December 2005, though one of its key provisions expires at the end of this year.

Will it be renewed? The law was only supposed to be temporary while markets were paralysed. Before September 11th insurers had generally included terrorist cover as standard. But egged on by property companies, which are worried about their buildings being blown up, insurers are now clamouring for the law's renewal. Jack Armstrong, a lawyer at Liberty Mutual, a big insurer, points out that compared with the sums of money the government spends on guarding airports and other security measures, the federal insurance programme is cheap. And private markets, argue insurers, do not have enough information with which to put any meaningful price on terrorist cover.

The point is reasonable, even if it means that, before September 11th, insurers were in a business they did not understand. Hurricanes are more predictable. American insurers, at least, have only one big attack to go on. Any knowledge of when there might be another is in government hands. Tellingly, reinsurers, which do not have to offer terrorism cover, have mostly not done so. “Absent some kind of government backstop, the insurance industry will be unwilling and unable to provide the amount of coverage that open economies need,” says Philip Crowley, of the Insurance Information Institute.

Perhaps, but Capitol Hill will not be keen on handouts to an industry awash with profits in an election year. Peter Wallison, of the American Enterprise Institute, a think-tank, says there is plenty of capital in the insurance business to cover any losses, and if losses are sufficiently large, the government will step in anyway. It might help the insurers' cause if they made their terrorism policies more comprehensive. At present many exclude chemical, biological and nuclear attacks, leaving much risk with the insured.

Reuters

Will Uncle Sam only look after his own?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Bundesbank

Welteke-class spat

Apr 15th 2004 | FRANKFURT
From The Economist print edition

A tussle over the integrity of a once-great central bank

TWO extra nights in a Berlin hotel paid for by Dresdner Bank two years ago are the unacceptable perk which will probably cost Ernst Welteke, president of the Bundesbank, his job. But not yet.

The affair has turned into a slugfest between Frankfurt and Berlin over the reputation and "independence" of Germany's central bank. Until Frankfurt state attorneys have examined the case, Mr Welteke stays suspended but will not resign. At stake, say angry officials at the Bundesbank, is not so much Mr Welteke's career, as the central bank's refusal to be pushed around or to have an unwanted successor foisted on it by the government in Berlin.

Mr Welteke's sin was to add a couple of nights to his stay in Berlin, courtesy of Dresdner Bank, after attending celebrations marking the introduction of euro notes and coins in December 2001. Copies of the €7,660 ($6,820) bill were sent anonymously to the finance ministry earlier this month. Why now? Conspiracy theories abound.

The Bundesbank, once renowned defender of the mighty Deutschmark, is today just a cog in the European system of central banks. Its president has a single vote on the governing council of the European Central Bank. Yet domestically he can still be a thorn in the government's side. Mr Welteke has crossed swords with Hans Eichel, the finance minister, on the budget deficit—which he wants reduced—and on gold.

The government, many suspect, wants to sell some of the bank's gold reserves to plug budget gaps before the next general election in 2006. Mr Welteke wants any sales to be invested in a fund to educate future generations. The spat may be a little academic—a budget committee mainly rejected the idea of selling gold—but the suspicious see Mr Welteke as playing a scapegoat for an irritated Mr Eichel.

The government appoints Bundesbank presidents but cannot fire turbulent ones. That is the job of the Bundesbank's eight-man executive board. So Mr Welteke and his co-executives can play for time, and perhaps influence the choice of his successor. Jürgen Stark, the acting president, is the favoured internal candidate, but belongs to the Christian Democrat opposition. The government is reckoned to prefer Caio Koch-Weser, a senior finance ministry official more likely to toe the party line. But Bundesbankers are hostile to him. Mr Koch-Weser was once rejected by the Americans as a candidate to run the IMF because he was not well enough known.

Should Mr Welteke have accepted the hospitality? The governors of America's central bank, the Federal Reserve, have clear guidelines: no gifts or perks, including hotel expenses, worth more than $20. More than that and the Fed pays. The European Central Bank wrote its own code in May 2002—since Mr Welteke's stay in Berlin—recommending that benefits may be accepted only from within the European system of central banks. Other paid work must not tarnish the image of the ECB. On April 7th, the Bundesbank decided to adopt the same code.

Quite right, too. But one participant recalls a junket during last year's IMF meetings in Dubai in which bankers, journalists and finance officials—including Mr Eichel—roared off into the desert for a torch-lit dinner, courtesy of Commerzbank. "Outlawing those get-togethers would be a pity," he says.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

A remedy for financial turbulence?

Apr 15th 2004
From The Economist print edition

In the first of a series of articles on the Copenhagen Consensus project*, we look at financial instability

THE severity and frequency of financial crises, especially the combined currency and banking collapses of the past decade, have made financial instability a scourge of our times, one that bears comparison with damage inflicted by famine and war. In a new paper for the Copenhagen Consensus, Barry Eichengreen, from the University of California, Berkeley, has reviewed the literature, attempted to count these costs, and to weigh them against the costs of a particular proposal for remedial action.

The costs can be reckoned in stalled growth and stunted lives. The typical financial crisis claims 9% of GDP, and the worst crises, such as those recently afflicting Argentina and Indonesia, wiped out over 20% of GDP, a loss greater even than those endured as a result of the Great Depression. According to one authoritative study, the Asian financial crisis of 1997 pushed 22m people in the region into poverty. For developing countries, currency crises are an important subset of financial crises. Mr Eichengreen, while cautioning against taking the precision of such estimates too seriously, reckons that the benefit which emerging-market countries would reap if such crises could be avoided altogether would be some $107 billion a year.

One ready way to secure those benefits, you might think, would be to stifle financial markets. In impoverished parts of Africa, for example, credit crunches are relatively rare, because credit is always hard to come by. But as a rule such a solution would be more costly than the problem. Wherever financial markets are absent or repressed, savings go unused, productive economic opportunities go unrealised and risks go undiversified. If India's banks and stockmarkets were as well developed as Singapore's, India would grow two percentage-points a year faster, according to one study.

To grow fast, and keep growing quickly, countries need deep financial markets—and the best way to deepen financial markets, most economists agree, is to liberalise them. Does this mean that countries must open their financial markets to foreign capital, thus exposing themselves to the risk of currency crises? Or should they impose capital controls, confining the perversity of financial markets to national borders, where the central bank retains the power to offset it? Foreign direct investment aside, China's capital markets are still largely closed to outsiders. Yet it has no shortage of credit. For other countries, though, the evidence is mixed. A fair reading of the studies, and there have been many, suggests that, for most countries, opening up to foreign capital will deliver faster growth in most years—punctuated by a damaging financial crisis about every ten years. Some economists argue that periodic credit crunches are the price emerging markets must pay for faster growth.

What might be done to make financial crises less common? The answer depends on the causes of financial meltdown. Governments bring some crises on themselves by pursuing fiscal and monetary policies that are inconsistent and unsustainable. Such self-defeating policies may be the symptom of deeper flaws in the body politic. If so, there is little outsiders can do. But some countries' financial fragility results simply from their need for foreign investment. In the most susceptible countries, firms and banks borrow heavily in dollars, while lending in local currencies. If the value of the local currency wobbles, this mismatch between domestic assets and foreign liabilities is cruelly exposed.

Why are the assets and liabilities of emerging markets so ill matched? Perhaps because poorly supervised and largely unaccountable managers have scant reason to be careful with other people's money. But Mr Eichengreen offers another reason. International investors are very choosy about currencies. Most consider only bonds denominated in dollars, yen, euros, pounds or Swiss francs. This select club of international currencies is locked in for deep historical and structural reasons. Thus, poor countries that

want to borrow abroad must bear currency mismatches through no fault of their own.

Match-making

If this is the problem, possible solutions follow naturally: either create a common world currency, used by rich and poor alike, or invent a liquid, international market for bonds denominated in the pesos, bahts and rupiahs that emerging markets are obliged to use. The first solution, even if it were desirable, is politically impossible; the second is merely very difficult. Mr Eichengreen spells out in his study an ingenious plan to make it a little easier. Briefly, he proposes the creation of a market for lending and borrowing in a synthetic unit of account, a weighted basket of emerging-market currencies. Such bonds would be popular with investors, since the currency would be more stable than the sum of its parts and, at first at least, carry attractive yields. Importantly, such a market, if it could be established, would eventually let emerging-market economies tap foreign capital without currency mismatches. This is because those, such as the World Bank, that issued such bonds would be keen to reduce their exposure to the basket by lending to the countries in that basket in their own currencies.

However, there is a cost: the extra yield that the Bank and others would need to offer to attract buyers of the new instruments. Mr Eichengreen estimates that this initial cost would be no more than $545m a year—a small sum compared with the $107 billion that would be saved if currency crises could be avoided.

---

* The Copenhagen Consensus project, organised by Denmark's Environmental Assessment Institute with the co-operation of *The Economist*, aims to consider, and to establish priorities among, a series of proposals for advancing global welfare. The initiative was described in our Economics focus of March 6th. That article can be read here, along with other material, including an article on disease published only online this week.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Aggression and culture

The peacemakers

Apr 15th 2004
From The Economist print edition

Corbis

A non-human example of the cultural transmission of social norms

IS AGGRESSIVE behaviour innate or learned? In baboons, it seems, it is learned. A surprising natural experiment, reported in *Public Library of Science Biology*, an online journal, suggests that the level of violence in baboon society is culturally determined.

The story begins in 1983, in the Masai Mara Reserve in Kenya. Robert Sapolsky, a primatologist at Stanford University, was five years into a study of the reserve's olive baboon population when one of the troops he had been observing suffered an outbreak of tuberculosis which killed half of its males. Since the source of the infection was a garbage dump being used as a food supply, and control of this dump was contested with another troop, the males who became infected and died were the more aggressive individuals in the troop—ie, those best fitted to the task of fighting for food. The result was that the level of aggressive behaviour within the troop dropped off markedly.

Dr Sapolsky was understandably upset by what had happened and decided to start again with another troop—one with a more normal sex ratio and social structure. So he turned his attention to a troop 50km away until 1993, when he wanted to show his new colleague (and wife) Lisa Share his original research site. To his surprise, ten years after the natural cull of aggressive individuals had started, the behaviour of the troop's males was still pacific. The reason for that surprise was that every male who had been in the troop in 1983—not just the ones who had died of tuberculosis—had gone. All of the troop's males were incomers. (Male olive baboons seek their fortunes in troops other than the ones they have been born into.)

Dr Sapolsky and Dr Share decided to investigate further. They began to observe Forest Troop (as Dr Sapolsky dubbed his original subjects) in detail. They compared the troop's behaviour both to what it had been before the outbreak, and to that of the other troops they had been studying.

Some things had not changed. Top-rank males in all groups stayed boss for roughly the same length of time—a year. So-called approach-avoidance interactions between males, in which a high-ranking male displaces a lower-ranking one without any overt violence, happened about as often in one group as in another. But the detailed pattern of these interactions was different. In the new Forest Troop, males tend to “pick on individuals their own size”, attempting to displace those of adjacent rank, whereas in more

traditional groups top monkeys tend to bully those at least two ranks below them—animals that have no chance of fighting back. The new Forest males are also less likely to launch attacks on females.

Subordinate males in the new Forest Troop are under less physiological stress, too. When Dr Sapolsky had sampled blood in the pre-outbreak Forest Troop, he had found high levels of hormones called glucocorticoids, which are released in response to stress. Not so in the new Forest Troop. Glucocorticoid levels in its members are low. In fact, even the act of sampling blood had differentiated high- from low-ranking males in the old days. Dominant males suffered no altered behaviour, whereas subordinates scratched themselves, shook their heads incessantly and ground their teeth. No longer.

Cultural transmission of behaviour has been seen in many animals besides humans. But until now, it has concerned what foodstuffs are good to eat, how to make and use tools, and how to communicate (many bird songs, for example, have learned regional dialects). Cultural transmission of, for want of a better word, manners, has never before been observed outside *Homo sapiens*.

How it came about is still a bit of a mystery, though when Dr Sapolsky and Dr Share weighed the evidence they felt it supported the idea that males new to the troop somehow picked up on how they were expected to behave by watching what was going on, and then found life easier if they did likewise. It also seemed to have a lot more to do with how the Forest females treated newcomers, than their treatment by existing Forest males. The females, it seems, like the new arrangement and are keen to preserve it.

However, such pacific behaviour is unusual in baboon troops, which suggests it is an unstable arrangement. In particular, it might be overthrown if several males with different ideas arrived at the same time. Dr Sapolsky and Dr Share are therefore watching the troop intently, to see what, if anything, causes its males to revert to the tried and tested macho methods of normal baboon life.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

General relativity

Turn, turn, turn

Apr 15th 2004
From The Economist print edition

A new satellite will test Einstein's magnum opus

IT WAS the moment that catapulted Albert Einstein to world fame. In 1919, two teams of British astronomers led by Sir Arthur Eddington journeyed to the southern hemisphere to observe a solar eclipse. Einstein's general theory of relativity, an explanation of how gravity works, predicts that the sun bends light that passes close to its surface a few degrees off-course. That will cause stars in the same part of the sky as the sun to look out of place. Because of the sun's overpowering brightness, such a deviation cannot normally be observed. But with the sun's disc obliterated by the eclipsing moon, Eddington's colleagues were able to confirm the deviation was as Einstein said it should be, and that Newton's model of gravity, then two centuries old, was wrong.

A triumph. But experimental tests of general relativity since then have been few and far between. So the launch of *Gravity Probe B*, a spacecraft that is scheduled to lift off from Vandenberg Air Force Base in California at 10.01am on April 17th, has a particular significance for physicists.

Using a near-perfect set of gyroscopes, *Gravity Probe B* will test two predictions made by general relativity. One, the geodetic effect, has been measured before by bouncing lasers off the moon, but the new measurements will be 20 times more precise. The other, frame-dragging, has never been measured before.

The geodetic effect is caused by a distortion that the Earth's mass makes in the fabric of space. This distortion should cause the gyroscopes to wobble on their axes—a phenomenon called precession. In this case, though, the angle through which the axes will precess is predicted to be a mere two-thousandths of a degree.

That may sound taxing to detect, but it is nothing compared with the precision required to measure frame-dragging. This phenomenon is a spiral distortion of space which should—if relativity is correct—happen when massive bodies rotate. (In essence, such bodies drag space round with them.) Frame-dragging is predicted to cause an additional precession of one hundred-thousandth of a degree, perpendicular to that caused by the geodetic effect.

To measure that, the four gyroscopes in *Gravity Probe B* are made of fused quartz spheres, which will not expand or contract as the temperature changes. These spheres have been polished so perfectly that, if they were magnified to be the size of the Earth, the blemishes on their surfaces would be less than five metres high.

These perfect spheres are coated with niobium, a metal which, when kept close to absolute zero, is a superconductor. A spinning superconductor creates a magnetic field whose direction indicates its axis of rotation—and therefore, in this case, that of the gyroscope of which the niobium is a part. But even though outer space is cold, it is not cold enough to ensure superconductivity, so the entire apparatus has to be kept in a flask of liquid helium. And to cap it all, the rocket that will put *Gravity Probe B* into orbit has to be launched within a “window” a mere one second long if it is to deliver its payload into the correct orbit. If it misses this window, further opportunities occur at intervals of 23 hours and 56 minutes—a period known as a sidereal day.

All this may seem a lot of effort to confirm a theory that most physicists assume is true. But it is important to be sure. After all, those physicists' forebears were equally convinced about Newton's theory until it proved wrong. In any case, general relativity directly contradicts quantum mechanics, the other great physical theory of the 20th century, so more and more precise tests need to be carried out to find out what cracks might exist in either theory.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Ancient jewellery

A shell game

Apr 15th 2004
From The Economist print edition

They may not look like much, but these tiny shells, which belong to a marine snail called Nassarius kraussianus, are believed to be the oldest examples of jewellery yet discovered. They come from Blombos cave in South Africa, a site that has already yielded the earliest examples of abstract art—grids of lines scratched on stone. Christopher Henshilwood, of the University of Bergen, in Norway, and his colleagues, report in this week's Science that they have found 41 shells pierced in an identical manner, as though to be threaded on a necklace or bracelet. Most come from a layer of the cave floor that is 75,000 years old, and thus represent more evidence that Homo sapiens was artistically active long before the first of the famous cave paintings found in southern Europe were made, some 35,000 years ago.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Honeybees and the internet

The internest

Apr 15th 2004
From The Economist print edition

Bees can teach computer programmers a lesson

HONEYBEES want to make honey, while internet host providers want to make money. And the rhyme is not the only thing to link honeybees and internet host providers, who operate vast warehouses full of server computers on behalf of their customers. Sunil Nakrani of Oxford University and Craig Tovey of the Georgia Institute of Technology, in Atlanta, have recently developed what they believe is an efficient way of organising internet servers, by mimicking the behaviour of honeybee colonies.

The unpredictability of internet traffic (sudden surges of shoppers or stockmarket trading; the ups and downs of an internet auction) gives firms which run servers quite a headache. To maximise their profit, they have to juggle their computers between different applications in order to adapt to changing levels of demand. Only one web-application can be loaded on to a computer at one time, and switching between applications incurs a penalty of five to seven minutes of downtime while the computer is reconfigured.

Honeybees have a similar problem. Patches of flowers vary in quality, so a colony needs to “decide” how many bees will forage at each patch and how long they will forage, in order to maximise the rate of nectar collection.

Millions of years of evolution have provided the bees with a pretty good solution. Around one-fifth of the bees in a hive are employed as nectar collectors. Their job is to zip back and forth to flower patches, gathering batches of nectar. On returning to the hive, they transfer their takings to one of the stay-at-home food-storer bees, who then stash it in a honeycomb.

A nectar-collecting bee judges how good its flower patch is, relative to the patches being visited by its hive-mates, by seeing how long it takes to find an unemployed food-storer bee. If it takes ages, then the forager concludes that its patch is nothing special, and that most of the other forager bees must have had successful runs, too. But if there is a plethora of food-storer bees ready to take the nectar, then the forager realises that it has struck lucky.

Using this information, the forager decides whether its flower patch is worthwhile. If so, it signals to others to follow it back by doing the famous waggle dance. The length of this dance indicates how profitable a flower patch is likely to be.

Dr Nakrani and Dr Tovey have exploited the honeybees' strategy and applied it to the problems of internet hosts. By comparing individual servers to foraging bees, and customer requests to flower patches, the two researchers have developed a “honeybee” algorithm for internet-server “hives”. Instead of waggle-dancing, a server produces an “advert”, which it sends to the other servers in the hive. The duration of this advert reflects the importance and profitability of that server's customers. Other servers that read the advert act like worker bees following a waggle dance—judging on the basis of the advert, and of their own recent experience, whether to switch from the customers they are currently serving to the new ones being served by the server that produced the advert.

Honeybees and internet servers share similar problems right down to the finest level of detail. For example, the downtime penalty incurred when a computer is switched from one web-application to another can be compared to the trade-off for a honeybee that is switching flower patches—an activity that usually requires several attempts before a profitable new patch is located.

To see whether their analogy is useful, Dr Nakrani and Dr Tovey tested the honeybee algorithm against the so-called greedy algorithm currently used as the basis for the allocation of servers by most internet host providers. A greedy algorithm is backward looking. It divides time into fixed periods and allocates

servers to customers for a period by working out what would have been the most profitable arrangement in the preceding one.

When internet traffic was highly variable, the honeybee algorithm outperformed greedy by as much as 20%. If the traffic became more uniform, then the greedy algorithm began to outperform honeybee. However, most internet traffic is, indeed, highly variable. That suggests Dr Nakrani and Dr Tovey might be on to something. As is often the case with human inventions, nature got there first.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Volcanoes

Winters of discontent

Apr 15th 2004
From The Economist print edition

Volcanic activity seems to follow the seasons

ON JANUARY 17th 2002, lava flowing from Mount Nyiragongo in Congo wreaked havoc on Goma, a nearby city. On January 5th of the same year Piton de la Fournaise, the resident volcano on Reunion, an island in the Indian Ocean, also blew. At first glance, the coincidence of these events may seem just that—a coincidence. However, researchers at Cambridge University are suggesting that there is more to it than meets the eye, and that volcanoes are more likely to erupt in some months of the year than others.

In an article in a forthcoming edition of the *Journal of Geophysical Research*, Ben Mason and his colleagues will publish an analysis of the Smithsonian catalogue of volcanic eruptions, which records more than 3,200 such eruptions from 1700 to 1999. This analysis reveals that the months from January to March have up to 18% more eruptions than average. Seasonality was also observed in the eruptions of single volcanoes, such as the 7,100 small explosive events recorded between 1956 and 1997 at Sakurajima in Japan—though here the eruption rate peaked in November.

The team's first instinct was that this periodicity was to do with a phenomenon called Earth tides. These are deformations of the Earth's crust caused by the gravitational pull of the sun and the moon. Such tides are analogous to those in the sea, though the amplitude of the tidal waves involved is far smaller. Unfortunately for this hypothesis, variations in Earth tides failed to correlate with variations in volcanic activity. So the team turned to the climate as a possible explanation.

Every year, changes in snow and ice cover, and soil moisture, on the continents (which are mostly in the northern hemisphere) lead to the seasonal movement of over a thousand billion tonnes of water between the northern and southern hemispheres of the Earth. This changes the weight of the continents, the pressure of the atmosphere and the depth of the sea. The upshot is a periodic deformation of the crust with an amplitude of about 1cm.

Although such a deformation may seem rather small to influence global volcanism, it is about the same magnitude as that caused each year by the movement of the rocky “plates” of which the crust is composed. Since most volcanic activity is caused by the jostling of those plates, it is reasonable to suppose that the details of eruptions could be affected by a seasonal deformation of this magnitude. It is not that the distortions are causing eruptions. Rather, they affect the timing of eruptions that would have happened anyway.

If this explanation is correct, it could alter understanding of the interaction between volcanic eruptions and the climate. At the moment, this is thought of as a one-way street, with ejecta from large eruptions hanging around in the stratosphere, blocking sunlight and cooling things down for several years. This happened, for example, after the eruption of Mount Pinatubo in the Philippines in 1991. However, the team's discovery suggests that, to the extent such cooling slows down the transfer of moisture between the hemispheres, it might, in turn, affect volcanic activity.

For the moment, this is speculation. But Mr Mason and his colleagues have certainly shown how subtle and unexpected the interactions between various parts of the Earth can be.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

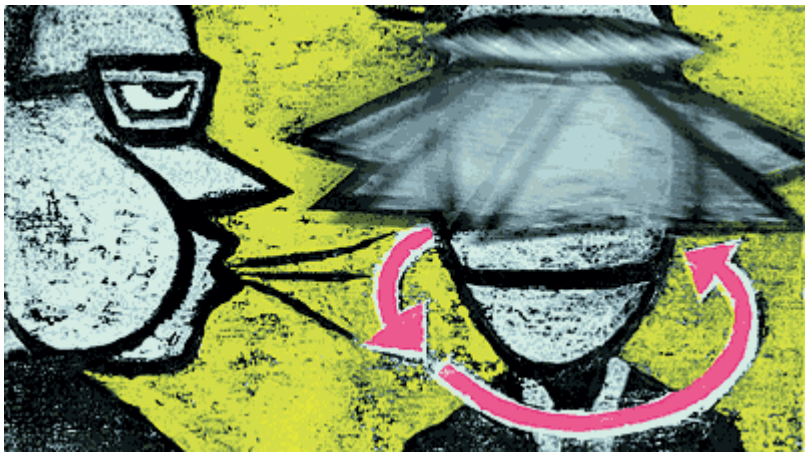
PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Changing minds

Might the proper study of management be man?

Apr 15th 2004
From The Economist print edition

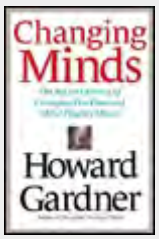


A Harvard psychologist turns his mind to changing yours

THE “science” of management is largely derivative: a mix of military strategy, the economics of the firm and the engineering of processes. Less frequently than it should, it takes ideas from the field of psychology, and some of them have had considerable influence. The idea that there are two distinct management styles, the authoritarian style and the participative style—“Theory X” and “Theory Y”—developed by Douglas McGregor in “The Human Side of Enterprise” 40 years ago was influential in corporate America long after the author's early death. A decade ago McGregor still featured as one of the most popular management writers of all time.

Today, management again seems eager to borrow from the field of psychology. After a decade in which its prime focus was first the re-engineering of business processes and then the measurement of “value added”, the science has turned its attention to the humans at the heart of the corporate machine. In that, it may be taking a lead from economics, which two years ago awarded its Nobel prize to Daniel Kahneman, a psychologist. Turning his back on neoclassical economists, who assume humans are crisply rational consumers, Mr Kahneman studied the fuzzy way in which people in their daily economic lives perceive things like risk.

Changing Minds: The Art and Science of Changing Our Own and Other People's Minds
By Howard Gardner



Harvard Business School Press; 244 pages; $26.95

Buy it at
Amazon.com
Amazon.co.uk

Two other influences may lie behind management's new-found enthusiasm for the science of Freud and Jung. The turmoil at the turn of the century, when stockmarkets' and businesses' fortunes rose and fell like boats in a force eight gale, increased managers' awareness that they live in a world that is not just ever-changing, but is changing ever more quickly too. “Change” is a buzzword in management literature today. Among other things, companies realise that they have to change, frequently and radically, the attitudes and practices of much of their workforce. For help they are turning to psychology.

The other influence comes from the spate of corporate scandals in America and Europe, and the subsequent soul-searching about the corruption of leadership. The study of leadership has, in the view of many of its more traditional exponents, gone “soft”. Out are the sturdy reminders of how the likes of Alexander and Shackleton led their men through impossible hardship; in are the exhortations to executives to examine their inner selves. “Get thee to a personal trainer,” is the fashionable advice.

A recent issue of the *Harvard Business Review* recommended that its high-flying readers “learn to navigate the twists and turns of their emotions”. (It is assumed that the leaders of Enron, Tyco and the like threw away their emotional compasses before they ever came close to a boss's chair.) “When there's dissonance between an executive's inside and outside,” the journal warned, “he's got trouble.”

Nobody is more skilled at sensing the management *zeitgeist* than the Harvard Business School's publishing empire, and “Changing Minds” came about when its editorial director persuaded Harvard University's Howard Gardner, one of the most influential psychologists of his generation, to turn his thoughts to a business-related subject: the way that people, in the workplace and elsewhere, can be persuaded to change their minds.

The dark side of the mind

Mr Gardner is best known for “Frames of Mind”, a book published in 1983 in which he expounded the idea, now almost taken for granted by the American educational establishment, that the mind is not a unidimensional phenomenon whose development can be measured by a single IQ test. He proposed that we have “a multitude of intelligences”—for example, linguistic, mathematical, musical, spatial and interpersonal. Each of these is independent of the others, and each develops at its own unique pace.

In “Changing Minds”, Mr Gardner applies his cognitive framework to the task of persuading people to adopt new ways of thinking about matters of importance. Like any slickly published management author, he comes up with a list of seven memorable elements, all of them conveniently beginning with the same two letters of the alphabet. His seven “Re's” (including reason, resonance, research, real-world events and resistances) are the “levers” that can be used to help change minds. “I think of them as arrows in a quiver,” he says, ready to be drawn upon in different combinations under different circumstances.

The author claims that Margaret Thatcher drew on resonance and real-world events to change the minds of the British people in the 1980s; while Robert Shapiro, a lawyer who, as head of Monsanto, tried to change the world's mind about genetically modified foods, failed because he “was unprepared for the resistances” that he encountered.

Mr Gardner presents the seven Re's as something “I have identified”. But they seem to be the fruits of his observation rather than the findings of more thorough research. The subject has huge implications, hinted at when Mr Gardner describes the fundamentalist as someone who “voluntarily decides that he will no longer change his mind in any significant way”. The son of Jewish refugees from Nazi Germany, Mr Gardner is well aware that Hitler was a peculiarly persuasive mind-changer. This subject is too big and too dark to be served casually for the undemanding business reader.

Changing Minds: The Art and Science of Changing Our Own and Other People's Minds.
By Howard Gardner.
Harvard Business School Press; 244 pages; $26.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

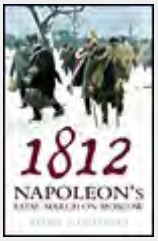
Napoleon in Russia

Horse dung and all

Apr 15th 2004
From The Economist print edition

EVERYONE knows the story but, according to Adam Zamoyski, almost nobody knows what really happened. That is what made him want to write about Napoleon's disastrous attack on Moscow in 1812, which cost the lives of 400,000 men, less than a quarter of them in battle. The result is a huge book, stuffed with gruesome and telling details, that leaves the reader stunned and disgusted in equal measure.

1812: Napoleon's Fatal March on Moscow
By Adam Zamoyski



HarperCollins; 644 pages; £25.

Buy it at Amazon.co.uk

The war was quite unnecessary. In 1811 Napoleon was master of almost all of Europe. Only Britain, through its navy and the Duke of Wellington's campaign in Spain, was maintaining armed resistance. Russia was an ally; the tsar, Alexander I, adored the French emperor.

But Napoleon's benighted protectionist policy, the Continental System, was hurting Russia's economy. He feared that the resulting discontent might eventually push Russia into an alliance with Britain. Perhaps a touch overconfident and careless after his great victories in previous campaigns, he decided to teach Russia a quick lesson, hoping then to restore friendly relations and turn to other targets: Turkey, perhaps, or even India.

Having made that mistake, Napoleon then made several more. He neglected or outright offended important allies, such as Austria, Prussia and Sweden. He failed to work out the details of fighting a campaign in a big poor country. Fighting in small rich ones, his troops and their horses had been able to buy what they needed from local farmers. The desolate, dirt-poor wastes of western Russia were quite different.

As a result, his army marched on an increasingly empty stomach. The soldiers (and more importantly their horses) were hungry, thirsty and ill-shod. These weaknesses were disguised by the still greater failings of the enemy. Time and again, the squabbling, incompetent Russian generals failed to put up much of a fight, and the Bonapartist army marched ever farther towards Moscow.

The battle of Borodino, fought outside the city on September 7th 1812, was the greatest mass slaughter in the history of warfare until the Battle of the Somme in 1916. Napoleon's troops suffered dreadful losses. But the Russians were so bloodied that they retreated, burning Moscow on their way. Napoleon's troops entered what was left of the city, only to find that Russia shrugged off the loss—leaving the invaders to wonder which vast distance they were now going to have to cover.

Even then, Napoleon could have avoided disaster. Mr Zamoyski reckons that had he retreated from Moscow two weeks earlier, his army—rested and refreshed—would have reached Vilna (modern-day Vilnius) in good order, and could have mounted a successful invasion of Russia the following year.

Instead, the retreat was delayed until late October. A cold snap, coupled with the harrying tactics of the Russian Cossacks, turned the withdrawal into one of the most disastrous military manoeuvres in history. Even so, the incompetence of Russian leaders such as General Mikhail Kutuzov allowed Napoleon himself, and some of his hardier troops, to escape to fight another day.

It is a gripping tale. Mr Zamoyski has trawled the memoirs and military histories to create a mosaic of personal accounts and statistics. His elegant prose rarely falters, and there is a pleasing number of accurate and illuminating maps. If the book has a weakness, it is in proportions. There is only so much a reader can absorb about frost-bite, raw horse liver and the general ghastliness and chaos of military life.

It becomes hard to imagine that discipline, tactics and strategy are still part of the picture. A bit more explanation about how intelligence was gathered, plans made and orders transmitted might convey better how the whole horrid business carried on as long as it did.

1812: Napoleon's Fatal March on Moscow.
By Adam Zamoyski.
HarperCollins; 644 pages; £25.
To be published in America as "Moscow 1812" by HarperCollins in August

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Copyright law

Killing creativity

Apr 15th 2004
From The Economist print edition

IMAGINE that drug companies were so successful at lobbying governments that they won an extension of their patents from 20 years, as they are today, to 100 years; and that the scope of those rights was extended so that future medical discoveries were in effect blocked. The ensuing public outcry would almost certainly result in the law being rewritten in favour of scientific advancement.

Yet this is actually happening (and with little public scrutiny) in a different area of intellectual property: copyright law. As more and more forms of content go digital, the owners of that content are becoming more possessive and turning increasingly to the law for help. The result is a “permission culture”, argues Lawrence Lessig, a professor at Stanford Law School and a leading authority on internet law, where creators increasingly need legal approval for their works, not a “free culture” where creativity is presumptively allowed, as was the case in the past.

Copyright was originally designed to restrict publishers from exerting too much control over information; today it constrains individuals from creating new works. This is because, in America at least, the duration of copyrights has increased (from 28 years in the 19th century to as much as 95 years today), and their scope has widened (to include all works, not just the minority that used to be registered). It now also applies to almost all media, not just printed matter, and to derivative works. Such broad application was never intended, nor existed, in the past.

Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity
By Lawrence Lessig

The Penguin Press; 368 pages; $24.95 (free on the internet for non-commercial use)

Buy it at
Amazon.com
Amazon.co.uk

Although Mr Lessig's analysis sticks to America, the problem he identifies is increasingly a global one. As the internet and computing technology allow more efficient ways to create, share and transform content, large media companies are lobbying for laws and filing law suits to preserve their businesses. Recent suits by the Recording Industry Association of America for millions of dollars lost thanks to music piracy are but one example.

Instead of adapting to the internet, media companies are using the law to change the very features of the internet that make it so successful. Mr Lessig is no cyber-utopian promoting piracy or an end of copyright. Instead, he argues for a more reasonable balance, by redefining copyright law closer to the function that it served in the past. “A society that defends the ideals of free culture must preserve precisely the opportunity for new creativity to threaten the old,” he writes.

The author himself is a partisan. Seeing the deficiencies in copyright law, he co-founded an organisation in 2001 called Creative Commons to allow content-creators to license their works in ways that are open rather than restrictive. (Fittingly, “Free Culture” is available free online for non-commercial use under this system; within days of its release, the book was reproduced in numerous formats, including audio recordings.)

Mr Lessig took his arguments all the way to America's Supreme Court in October 2002. He lost, and the book in many respects is a reply to the majority of the bench who ruled against him. Free culture in Mr Lessig's view is akin to free markets—it does not mean a lack of regulation; it is just a vital platform for progress. Indeed, last year *The Economist* argued in favour of a return to the 28-year maximum copyright term as a decent starting point for reform. Among the solutions that Mr Lessig proposes—unconvincingly, alas—are copyright marking, registration and renewal, as was done in former times. His final suggestion: “fire lots of lawyers”.

Ultimately, “Free Culture” is about neither law nor technology, the author's areas of expertise. It is about power. Specifically, it concerns the way in which financial and political power are used by corporations to preserve the status quo and to further their own commercial interests. This may be to the detriment of something more socially valuable: a loss of creativity that can never be measured.

Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity. By Lawrence Lessig.
The Penguin Press; 368 pages; $24.95 (free on the internet for non-commercial use)

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

New fiction: Alan Hollinghurst

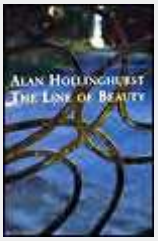
Pick-me-ups

Apr 15th 2004
From The Economist print edition

EDMUND WHITE described Alan Hollinghurst's first novel, “The Swimming Pool Library”, as the “best book about gay life yet written by an English author.” Published in 1988, just as AIDS was entering our vocabulary, it threw open a window on to a world that had long been kept half in shadow; if ever there was an openly gay novel that crossed over into the mainstream, this was it. Mr Hollinghurst's new book, which begins just as the “The Swimming Pool Library” ended, arrives with high expectations.

In the summer of 1983, with Margaret Thatcher in full, post-Falklands sail, Nick Guest, the skinny unawakened hero, casts off the obedient background offered by his parents and moves into an attic room in the Notting Hill home of the Feddens: Gerald, an ambitious new Conservative member of Parliament; his wealthy wife Rachel; and their predictably flaky children, Toby and Catherine. As the dance of the 1980s unfolds, Nick quickly takes up the Feddens' quickstep, with their braying, their grand parties and their holidays in the Dordogne.

The Line of Beauty
By Alan Hollinghurst



Picador; 616 pages; £16.99

Buy it at
Amazon.co.uk

Framed by the two general elections that returned Mrs Thatcher to power, Nick's personal awakening lies at the core of the book. A love affair with a black clerk, who first seduces Nick behind the shed in an exclusive communal garden in Holland Park, gives him his first taste of romance. But it is a later affair, with the feckless and beautiful son of a millionaire (a dark-eyed Lebanese) that throws into high relief the excesses and fantasies of the decade.

Buckets of cocaine, peerages bought with political donations and, inevitably, the dark sarcoma of AIDS; each joins the parade of brittle glitter. In case you miss the point, this is all meant to illustrate the descent into madness that supposedly accompanied Tory power.

Mr Hollinghurst's close observations of young men first exploring their sexuality are particularly good. But with the exception of an operatic set-piece in which Mrs Thatcher agrees to grace a party at the Feddens, and Nick, by now spinning like a top, asks her for a dance, Mr Hollinghurst's Tory London is peopled only with caricatures, porky vessels as noisy as they are empty. With its tender evocation of a subtle, rarely illuminated world, its rich characterisation and its simple prose, “The Swimming Pool Library” broke down the walls that had kept gay writing for so long in a ghetto. “The Line of Beauty”, by contrast, is fine when it deals with gay life. But that is all.

The Line of Beauty.
By Alan Hollinghurst.
Picador; 616 pages; £16.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Popular physics

All strung out

Apr 15th 2004
From The Economist print edition

THIS overly ambitious attempt to explain almost everything in the universe feels as if it started life on a publisher's wish-list rather than in the mind of the author. Brian Greene is a talented writer whose first book, “The Elegant Universe”, had a more modest goal: it sought to explain “string theory”, currently the most popular explanation of fundamental physics, to the layman. That was not a simple task, but Mr Greene, a string theorist himself and a professor of physics and mathematics at Columbia University in New York, did it well. “The Elegant Universe” became that rarity—a popular physics book.

For every surprising bestseller, of course, there has to be a sequel. And Mr Greene's new book, which seeks to chronicle physicists' descriptions of space and time, is that sequel. It is not the first, nor will it be the last, to disappoint.

At his best, Mr Greene is a marvellously talented exponent of physics—for example, his discussions of entropy, the mathematically rigorous description of disorder, delve deep into the heart of physics yet remain a pleasure to read. The catch is that, in this book, he is not often at his best. He falls at the same hurdle that trips many others with similar ambitions.

While the book sets out to discuss one aspect of physics—the nature of space and time—it feels obliged to go on a circumnavigation of much of the physics of the past 100 years in order to explain the one specific aspect. This is a task that has been better done before—for example, by Einstein himself. It is also a task that Mr Greene approaches in something of an indirect fashion. By abandoning the narrative continuity that would underpin a conventional history, he ends up leading the reader on a meandering path through the maze of modern physics, an approach which is highly confusing to the novice.

And the book is clearly pitched at the novice. Equations are banished to the copious footnotes, and the text is over-peppered with allusions to popular culture, for the most part television shows such as “The Simpsons” and “The X-Files”. The allusions serve to distract rather than to amuse, as do Mr Greene's attempts at outright jokes.

The footnotes, a substantial proportion of which are issued with the prefatory, “for the mathematically inclined reader” are another weakness. A serious attempt to read them abruptly breaks the flow of the text, but they themselves are not, for the most part, seriously designed to illuminate. Rather, they consist of cursory explanations that seem designed more as a nod to colleagues who already know the subject than as a pedagogical guide to the notional “mathematically inclined reader”. They are too short to offer any explanation to someone who does not already know the subject matter, even as they are too involved to be useful to anyone wary of mathematics.

The book also illustrates another danger in popular physics written by current practitioners. Although it is the more popular (and better-developed), string theory is but one of two contemporary approaches to the fundamental question about the nature of space and time. The other, loop quantum gravity, is given short, if civil, shrift by Mr Greene. In his previous book, which was about string theory, this was only fair. But in the current book, which claims to tackle a bigger subject, it is a serious omission.

The Fabric of the Cosmos: Space, Time, and the Texture of Reality.
By Brian Greene.
Knopf; 576 pages; $28.95.

The Fabric of the Cosmos: Space, Time, and the Texture of Reality
By Brian Greene

Vintage; 592 pages; $15.95. Allen Lane; Â£25
Knopf; 576 pages; $28.95.
Penguin/Allen Lane; £25

Buy it at
Amazon.com
Amazon.co.uk
Amazon.com
Amazon.co.uk

Penguin/Allen Lane; £25

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hollywood and Philip K. Dick

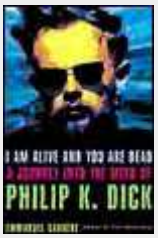
The world according to Dick

Apr 15th 2004
From The Economist print edition

Hollywood's fascination with a long-dead writer of pulp science fiction

ACCORDING to the official website of Philip K. Dick, the films made from his books have generated nearly $700m in worldwide box-office receipts. Not bad for an author who died more than 20 years ago in relative obscurity. Half-a-dozen films have been made from his books, including “Blade Runner”, “Total Recall”, “Minority Report” and, most recently, “Paycheck”. Another of his novels seems likely to have inspired “The Truman Show”, and, say some, his work may have influenced the “Matrix” series of films. And that looks unlikely to be the end of it. Those responsible for his estate say that the film rights to six more of his novels and four of his short stories have either been bought or optioned.

I Am Alive and You Are Dead: A Journey Into the Mind of Philip K. Dick
By Emmanuel Carrère



Henry Holt; 352 pages; $26

Buy it at Amazon.com

Dick yearned for literary acclaim, but in his lifetime he was known mainly as a prolific writer of pulp science fiction. He wrote more than 50 novels and over 100 short stories—work that was mostly fuelled by amphetamines and a cocktail of prescription drugs. He started psychoanalysis at the age of 14 and became so familiar with it that he used it to toy with his friends, his readers and even his shrinks, as a cat would with a mouse.

Reading his work has been described as falling through a series of trap doors. Before the LSD revolution in California, his adopted home, Dick was writing books that explored how the brain is a filtering mechanism that enables reality to be seen from many different perspectives. He gained a cult reputation as an LSD author, but took the drug only once and hated it.

Emmanuel Carrère's account of Dick's life focuses on the mind of a man who spent his time playing with other people's minds. Dick was obsessed with the unreal nature of reality, and the question of what is real. The sense of looking at something familiar and seeing it as if for the first time, or radically differently, was a central theme in his disturbed life.

The book traces many of his influences, from the death of his twin sister shortly after she was born to a succession of failed relationships. Dick lashed himself to women like a drowning man to a rock in a storm. Successively, though, his paranoia, craziness and pill-popping sent them running. Mr Carrère shows how Dick's tumultuous life story leaked on to the pages of his science-fiction novels.

But why is a strange, drugged-out and paranoid bygone of such interest to modern-day filmmakers? Partly because today's revolution in the biosciences, in particular in neuroscience, makes the questions he was asking particularly relevant. What is real if we can take drugs that alter our moods, or if we can tinker with our own memories? These issues were the flesh and bones of Dick's books, all those years ago.

He anticipated the terrible attractions of a technology that erases memory. People would simply have their painful memories removed. In the most recent film of his work, “Paycheck”, Ben Affleck rather unconvincingly plays a reverse engineer who routinely has his memory erased after he does a job of work, as part of commercial non-disclosure agreements. The character comes to believe that erasing the dull bits of his life is a good idea. All he is left with are the highlights.

“The stuff you erase doesn't matter,” says Mr Affleck's character. Of course, as the film progresses, we see how wrong he is: we are the sum of all our experiences—anything we erase makes us less than who we are. Although Dick's delight in twisting reality may be illuminating for us today, he paid a heavy price

for his unique vision. Accepting no single personal version of reality, with all its incumbent flaws, he had little grip on any world whatsoever.

I Am Alive and You Are Dead: A Journey Into the Mind of Philip K. Dick.
By Emmanuel Carrère.
Henry Holt; 352 pages; $26

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Leonard Reed

Apr 15th 2004
From The Economist print edition

Leonard Reed, tap dancer extraordinary, died on April 5th, aged 97

Telegraph

THE American Dream, it is often said, is losing its allure. Not so long ago millions of Americans lived their lives in the belief that with optimism, hard work and virtue, anyone, no matter how lowly his origins, could make good in the land of the free. Nowadays down-in-the-mouths point out that even Horatio Alger, the great 19th-century marketer of this belief, was hardly an exemplar of it; that most of the super-rich in the annual *Forbes* list started out with a tidy inheritance; and that you surely need that tidy inheritance plus two incomes to have a half-decent middle-class life, even in Peoria. How refreshing, then, to reflect on Leonard Reed, who rose from circumstances of extreme hardship to excel in one profession after another. And how inspiring, if you happen to harbour the fantasy of one day becoming a champion tap dancer, to know that that particular dream can become real even for a self-taught amateur.

Mr Reed was born in Oklahoma in 1907 to a half-black, half-Choctaw mother who died when he was two, and a white father whom he never saw. At the age of five—some say a bit more—he was sent to foster parents in Kansas City, where his foster father would beat him savagely. After each beating he would run away from home, but not from school, where his guardian would soon collect him. Eventually, having been caught drinking alcohol, he was saved from a stretch in a reformatory by showing the judge the weals on his back. Hugh Cook, his school principal, agreed to take him in and, in Mr Reed's words, thus saved him from a wasted life.

As a teenager, Mr Reed got a summer job selling popcorn at the local theatre, where the audience came to see vaudeville revues featuring the latest craze, a dance called the Charleston. Soon Mr Reed was a stylish exponent—so stylish, indeed, that he took first prize in a Charleston contest at another theatre. It was nearly his undoing. For in those days much of America was racially segregated and Mr Reed was formally considered black. But, light-skinned and blue-eyed, he could pass as white, and this was a contest for whites. Rumbled by two usherettes who knew him, he was pursued from the theatre by the manager shouting, “Catch that nigger!” Only his quick-wittedness in taking up the cry and posing as a pursuer enabled him to escape.

Mr Reed was a good pupil, good enough at least for Mr Cook to wish him to go to Cornell University, his alma mater. On his introductory visit, though, Mr Reed slipped into another dance contest and was immediately asked to join the show. He did. Soon he was touring with Hits and Bits, mimicking tap steps

and, by 1925, hanging out in the Hoofer's Club in New York. A couple of years later he joined Willie Bryant, another fair-skinned dancer, to form a team known as “Reed and Bryant—Brains as well as Feet”. This, with a bit of help from another partnership, the Whitman Sisters, led to Mr Reed's greatest legacy, the Shim Sham Shimmy.

Readers of *The Economist* will know that there is some disagreement about the Shim Sham, from which Mr Reed developed the Shim Sham Shimmy. Some say it started as a tap routine in the early 1900s; others credit it to the Brains-as-well-as-Feet team. In any event, the Shimmy, in its simple form, became a one-bar routine made up of four eight-bar choruses each consisting of the double shuffle, crossover, an up-and-back shuffle and another move sometimes described as “falling off a log”. In one form or another, the Shimmy soon swept the country. It is to this day considered an essential part of the repertoire of all tap dancers, especially as a finale.

The opportunities for Mr Reed now seemed endless. They were not, for segregation was to persist for another two decades and Mr Reed could not resist dancing in both all-white and all-black shows. Caught in the act—the wrong one—once again, he gave up his dance career in 1934 to become a producer, first with an all-tap show called Rhythm Bound and later, in the 1940s, at the Cotton Club in Harlem and elsewhere with musicians such as Cab Calloway, Count Basie and Duke Ellington, and singers such as Ethel Waters, Lena Horne and Dinah Washington.

As master of ceremonies at the Apollo Theatre in Harlem in the 1950s, Mr Reed met the heavyweight prize-fighter, Joe Louis, with whom he then teamed up to form a comedy act. He also turned his hand to writing and arranging music—for Louis Armstrong, Ella Fitzgerald and Lionel Hampton, among others.

Golf, women and song

More surprisingly, he made his mark upon the world of golf—thanks, once again, to the ambiguities of his race. A keen golfer, as well as hoofer, Mr Reed was issued with a player's card by officials of the Professional Golfers' Association in San Diego in 1951 who mistakenly took him for a white. This led to the abolition of the all-Caucasian rule, in force since the American PGA's foundation in 1916, and opened the way for black golfers such as Tiger Woods.

Mr Reed received many honours, including, in 2000, the Living Treasure in American Dance Award. He attributed his long life to “women, golf and show business”, and maintained an interest in all three to the end. Indeed, he was still teaching the Shim Sham Shimmy this year. Dream on, Horatio Alger, dream on.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Apr 15th 2004
From The Economist print edition

America's 12-month rate of consumer-price inflation held steady at 1.7% in March. But the core rate of inflation (excluding food and energy) jumped to 1.6% from 1.2% in February. The value of retail sales rose by a faster-than-expected 1.8% in March. Bond prices tumbled as markets started to worry that a rise in interest rates might be just around the corner. America's trade deficit narrowed in February as a weaker dollar helped to lift exports, but the 12-month deficit on goods widened to $557 billion.

Deflation is loosening its grip on **Japan's** economy. Wholesale prices rose by 0.2% in the year to March, the first year-on-year gain since 2000. Consumer prices in February were unchanged on a year earlier. Japan's current-account surplus in February was 46% bigger than a year earlier, partly thanks to rising exports to China.

In contrast, inflation continues to fall in Europe. In March, inflation declined to 1.7% in **France**, 1.1% in the **Netherlands** (its lowest since 1989) and to 0.7% in **Denmark**. **Sweden's** consumer prices fell by 0.1% over the same period. Output also remains weak in Europe: in the year to February industrial production rose by only 0.9% in France and by 0.2% in **Italy**.

The Bank of **Canada** cut its key interest rate by a quarter point to 2%. Recent economic data had been weaker than expected. Canada's jobless rate rose to 7.5% in March.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Apr 15th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.0	Q4	+ 5.5	+ 3.9	+ 3.1	– 0.1	Q3	+ 7.3	Q4	5.6	Mar	6.2
Austria	+ 0.4	Q4	na	+ 1.6	+ 2.0	+ 3.1	Jan	– 4.8	Jan	4.4	Feb	4.2
Belgium	+ 1.2	Q4	+ 2.4	+ 1.8	+ 2.0	+ 1.2	Jan	+ 0.8	Jan	12.7	Mar†	11.7
Britain	+ 2.7	Q4	+ 3.4	+ 3.2	+ 2.6	– 1.3	Feb	+ 6.5	Feb	4.8	Jan††	5.0
Canada	+ 1.6	Q4	+ 3.8	+ 2.8	+ 3.3	+ 0.5	Jan	+ 1.1	Jan	7.5	Mar	7.4
Denmark	+ 1.0	Q4	+ 2.4	+ 1.8	+ 2.2	– 1.0	Feb	+ 5.3	Feb	6.5	Feb	5.7
France	+ 0.6	Q4	+ 1.8	+ 1.8	+ 2.1	+ 0.9	Feb	– 2.2	May	9.6	Feb	9.4
Germany	+ 0.2	Q4	+ 0.9	+ 1.4	+ 1.7	+ 1.8	Feb	– 1.5	Feb	10.4	Mar§	10.6
Italy	+ 0.1	Q4	nil	+ 1.1	+ 1.8	+ 0.2	Feb	– 0.7	Jan	8.5	Jan	8.9
Japan	+ 3.4	Q4	+ 6.4	+ 3.2	+ 2.0	+ 6.9	Feb	+ 0.9	Feb	5.0	Feb	5.3
Netherlands	– 0.5	Q4	+ 1.2	+ 0.9	+ 1.7	– 2.0	Feb	– 3.0	Jan‡	6.4	Mar**	4.7
Spain	+ 2.7	Q4	+ 3.0	+ 2.8	+ 2.9	+ 2.0	Feb	+ 4.4	Feb	11.2	Feb	11.4
Sweden	+ 1.9	Q4	+ 2.2	+ 2.4	+ 2.4	+ 6.2	Feb	+ 7.4	Feb	6.0	Feb†	4.5
Switzerland	nil	Q4	+ 1.8	+ 1.6	+ 1.8	+ 1.7	Q4	+ 3.1	Jan	4.1	Mar†	3.6
United States	+ 4.3	Q4	+ 4.1	+ 4.7	+ 3.6	+ 2.7	Feb	+ 9.1	Feb	5.7	Mar	5.8
Euro area	+ 0.6	Q4	+ 1.2	+ 1.6	+ 2.0	+ 0.6	Jan	+ 0.5	Feb	8.8	Feb	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q4	+ 1.1	na	na	– 3.2	Feb	+ 7.3	Jan	9.0	Feb†	9.0
Greece	+ 5.0	Q4	na	na	na	+ 2.5	Feb	+ 1.3	Dec	na		na
Iceland	+ 4.9	Q4	na	na	na	– 0.3	2002	na		3.6	Feb†	4.1
Ireland	+ 2.7	Q4	na	na	na	+ 3.3	Feb	+ 0.3	Jan	4.6	Mar	4.3
Luxembourg	+ 1.3	2002	na	na	na	– 1.2	Dec	+ 4.1	Nov	4.4	Feb	3.8
New Zealand	+ 3.2	Q4	+ 2.4	na	na	+ 3.2	Q4	+ 6.0	Q4	4.6	Q4	4.9
Norway	+ 0.5	Q4	+ 2.4	na	na	+ 0.2	Feb	+ 2.6	Feb	4.2	Q4	3.7
Portugal	– 0.5	Q4	– 1.0	na	na	– 4.5	Feb	+ 0.6	Feb	6.6	Q4†	6.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Nov-Jan; claimant count rate 2.9% in Feb. §EU harmonised rate 9.3% in Mar. **Jan-Mar.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Apr 15th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.4	Q4	+ 3.0	+ 2.2	+ 2.6	– 1.1	Q4	+ 1.6	+ 5.9	Q4	+ 3.9
Austria	+ 1.4	Feb	+ 1.7	+ 1.2	+ 1.3	+ 3.0	Mar	+ 2.0	+ 2.2	Feb	+ 2.2
Belgium	+ 1.1	Mar	+ 1.8	+ 1.4	+ 1.5	+ 1.4	Feb	+ 0.4	+ 1.9	Q1	+ 2.4
Britain	+ 1.3	Feb*	+ 1.6	+ 1.5	+ 1.8	+ 1.6	Feb	+ 1.5	+ 4.4	Jan	+ 3.7
Canada	+ 0.7	Feb	+ 4.6	+ 1.5	+ 2.0	– 2.5	Feb	+ 2.8	+ 4.0	Jan	+ 1.8
Denmark	+ 0.7	Mar	+ 2.9	+ 1.4	+ 2.0	+ 0.3	Mar	+ 0.7	+ 3.7	Q4	+ 3.9
France	+ 1.7	Mar	+ 2.6	+ 1.8	+ 1.6	– 0.1	Feb	+ 2.2	+ 2.7	Q4	+ 3.5
Germany	+ 1.1	Mar	+ 1.2	+ 1.1	+ 1.1	+ 0.8	Mar	+ 1.3	+ 1.9	Jan	+ 2.5
Italy	+ 2.3	Mar	+ 2.7	+ 2.1	+ 2.1	nil	Feb	+ 2.8	+ 2.8	Feb	+ 2.2
Japan	nil	Feb	– 0.2	– 0.2	nil	+ 0.2	Mar	– 0.8	+ 2.0	Feb	+ 1.9
Netherlands	+ 1.1	Mar	+ 2.4	+ 1.4	+ 1.3	+ 0.6	Dec	+ 4.2	+ 1.8	Mar	+ 3.2
Spain	+ 2.1	Mar	+ 3.7	+ 2.3	+ 2.4	+ 0.7	Feb	+ 2.9	+ 3.3	Q4	+ 3.9
Sweden	– 0.1	Mar	+ 3.1	+ 0.9	+ 1.7	– 2.3	Feb	+ 0.6	+ 2.7	Dec	+ 4.0
Switzerland	– 0.1	Mar	+ 1.3	+ 0.4	+ 0.8	– 0.1	Feb	nil	+ 1.8	2002	+ 2.5
United States	+ 1.7	Mar	+ 3.0	+ 1.8	+ 1.8	+ 3.3	Jan	+ 2.5	+ 1.8	Mar	+ 3.2
Euro area	+ 1.6	Mar	+ 2.4	+ 1.7	+ 1.6	nil	Feb	+ 2.6	+ 2.5	Q4	+ 3.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.5	Mar	+ 1.6	na	na	– 1.8	Feb	+ 2.3	+ 3.7	Q4	+ 4.1
Greece	+ 2.7	Mar	+ 4.1	na	na	+ 1.4	Feb	+ 2.7	na		na
Iceland	+ 1.8	Mar	+ 2.2	na	na	+ 2.6	Mar	+ 3.3	+ 3.3	Feb	+ 5.6
Ireland	+ 1.3	Mar	+ 4.9	na	na	– 6.6	Feb	– 7.1	+ 6.1	Q4	+ 6.4
Luxembourg	+ 1.8	Mar	+ 2.7	na	na	+ 0.1	Dec	+ 1.3	– 0.4	Dec	+ 0.7
New Zealand	+ 1.6	Q4	+ 2.7	na	na	– 0.1	Q4	– 1.4	+ 2.3	Q4	+ 2.1
Norway	– 1.7	Feb	+ 4.8	na	na	– 1.1	Mar	+ 9.8	+ 3.9	Q4	+ 5.2
Portugal	+ 2.1	Feb	+ 4.2	na	na	– 0.5	Feb	+ 3.0	+ 0.8	Feb	– 0.4

*New series. RPI inflation rate in February: 2.5%.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Portfolio poll

Apr 15th 2004
From The Economist print edition

Portfolio poll

1st quarter 2004

▼▲ A change of 5% points or more on previous quarter
▼▲ A change of less than 5% points on previous quarter

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Credit Suisse PB	32 ▼	34 ▼	34‡ ▲	35 ▼	2 ▲	0	17	7 ▲	19 ▲	20 ▲
Henderson	60 ▼	25 ▼	15 ▲	52	3	11 ▲	13 ▼	3	15	3
Julius Baer PB	50 ▲	37 ▼	13‡	40 ▼	2 ▼	4 ▼	26 ▲	4 ▼	14 ▲	10 ▲
Informed P'folio Mgmt	45 ▼	55 ▲	0 ▼	57 ▲	5 ▲	3 ▲	11 ▼	6 ▲	14 ▼	4 ▲
Lehman Brothers	70	30	0	44 ▼	0	5 ▼	22 ▲	7	13 ▲	9 ▲
Robeco Group	55 ▲	45 ▼	0	51 ▼	3	11 ▼	14 ▼	5 ▼	12 ▲	4 ▲
Standard Life	60 ▲	38 ▼	2 ▲	50 ▼	3 ▲	9 ▼	16 ▲	5 ▲	10 ▲	7 ▲
Average	53 ▲	38 ▼	9 ▲	47 ▼	3 ▲	6 ▼	17 ▲	5 ▲	14 ▲	8 ▲
Neutral*	–	–	–	55 ▼	3 ▲	11 ▲	15 ▲	4 ▼	9 ▼	3 ▲

	Bond holdings by currency, %				
	Dollar	Yen	Sterling	Euro area	Others
Credit Suisse PB	90 ▲	0	0	10 ▼	0
Henderson	15	30	5	50	0
Julius Baer PB	88	0	0	7	5
Informed P'folio Mgmt	24 ▼	39 ▲	1 ▲	36 ▼	0 ▼
Lehman Brothers	42 ▲	18	4 ▲	32 ▼	4 ▲
Robeco Group	45 ▲	11 ▼	12 ▲	31 ▼	1 ▲
Standard Life	21 ▼	30 ▲	4 ▼	42	3 ▼
Average	46 ▲	18 ▲	4 ▲	30 ▼	2 ▼
Neutral*	21 ▲	30 ▲	5 ▲	40 ▼	4 ▼

*Morgan Stanley Capital International (developed) world equity index; Citigroup world government-bond index
†Of which 18% invested in alternative investments
‡Of which 9% invested in alternative investments

During the first quarter, our money managers' interest in American equities waned, while it increased for Asian and Japanese shares. Informed Portfolio Management, a Stockholm-based investment manager that joined our portfolio poll for the first time this quarter, is bucking the broad trends by boosting its holdings of American shares and trimming its exposure to Japan. Bonds are falling out of fashion. Four of the seven fund managers, including Julius Baer and Robeco Group, cut their bond allocations by at least five percentage points. Henderson sought a safe haven in cash. Many managers reduced their bets on euro-denominated bonds. Enthusiasm for dollar-denominated bonds was mixed, and only Robeco cut its exposure to bonds denominated in yen.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Apr 15th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Apr 14th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.6	+14.0	Feb	5.53	4.80	5.34	5.92	5.40	6.70
Britain	+ 6.8	+ 8.1	Feb	4.31	3.63	4.53	4.98	4.46	5.79
Canada	+10.3	+ 9.4	Feb	1.98	3.22	2.81	4.65	5.12	6.00
Denmark	+ 6.2	+ 6.6	Feb	2.11	2.69	2.48	4.30	4.41	5.45
Japan	+ 4.1	+ 1.9	Mar	0.02	0.02	0.12	1.53	0.66	1.58
Sweden	+ 1.0	+ 4.2	Feb	2.01	3.41	2.76	4.54	4.70	2.89
Switzerland	+24.0	+ 7.8	Feb	0.28	0.30	0.97	2.66	2.56	2.31
United States	+ 6.4	+ 4.0	Feb	1.03	1.21	2.10	4.38	3.97	5.85
Euro area†	+10.7	+ 6.3	Feb	2.05	2.56	2.36	4.12	4.16	3.96

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.16%, Japan No. 259 1.55%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.0%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Apr 15th 2004
From The Economist print edition

1995=100

	Apr 6th	Apr 13th*	% change on one month	% change on one year
Dollar index				
All items	100.0	98.9	+ 1.0	+30.2
Food	98.9	97.2	+ 0.5	+25.3
Industrials				
All	101.5	101.3	+ 1.6	+37.1
Nfa†	95.6	96.9	+ 2.7	+22.8
Metals	106.5	105.1	+ 0.8	+50.8
Sterling index				
All items	86.1	86.0	+ 1.2	+12.7
Euro index				
All items	109.1	109.3	+ 4.7	+18.0
Yen index				
All items	113.0	112.5	– 1.0	+15.7
Gold				
$ per oz	417.75	408.00	+ 1.2	+26.2
West Texas Intermediate				
$ per barrel	34.92	37.13	– 0.8	+26.5

* Provisional. † Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Apr 15th 2004
From The Economist print edition

Market indices

	Apr 14th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,440.8	3,462.9	3,274.9	– 0.4	– 0.6	+ 4.1	+ 1.1
Austria (ATX)	1,965.0	1,985.9	1,568.9	+ 1.2	– 1.1	+27.2	+20.2
Belgium (Bel 20)	2,476.1	2,517.3	2,244.2	+ 0.9	–32.8	+10.3	+ 4.3
Britain (FTSE 100)	4,485.4	4,559.1	4,309.4	+ 0.3	–35.3	+ 0.2	nil
Canada (Toronto Composite)	8,640.1	8,898.8	8,220.9	+ 0.6	–24.1	+ 5.1	+ 0.8
Denmark (KBX)	230.9	241.3	219.0	+ 0.1	–23.5	+ 8.1	+ 2.2
France (SBF 250)	2,551.1	2,594.4	2,411.5	– 0.5	–41.9	+ 5.8	nil
(CAC 40)	3,731.4	3,785.4	3,518.5	– 0.4	–46.1	+ 4.9	– 0.9
Germany (DAX)	4,012.8	4,151.8	3,726.1	– 0.2	–50.2	+ 1.2	– 4.3
Italy (BCI)	1,321.1	1,328.3	1,239.5	+ 0.7	–39.5	+ 5.1	– 0.6
Japan (Nikkei 225)	12,098.2	12,127.8	10,365.4	+ 0.2	–68.9	+13.3	+12.0
(Topix)	1,217.9	1,217.9	1,022.6	+ 0.7	–57.8	+16.7	+15.3
Netherlands (AEX)	349.9	364.8	326.3	+ 0.1	–50.1	+ 3.6	– 2.1
Spain (Madrid SE)	872.7	881.7	808.3	+ 0.8	–23.9	+ 8.0	+ 2.1
Sweden (Affarsvarlden Gen)	210.1	218.1	188.5	– 0.3	–47.5	+11.5	+ 4.1
Switzerland (Swiss Market)	5,761.3	5,934.4	5,469.0	– 0.1	–31.5	+ 5.0	nil
United States (DJIA)	10,377.9	10,737.7	10,048.2	+ 0.2	–11.5	– 0.7	– 0.7
(S&P 500)	1,128.2	1,157.8	1,091.3	+ 0.2	–26.1	+ 1.5	+ 1.5
(NASDAQ Comp)	2,024.9	2,153.8	1,901.8	+ 1.5	–59.9	+ 1.1	+ 1.1
Europe (FTSE Eurotop 300)*	1,008.4	1,026.2	957.9	– 0.4	–40.9	+ 5.3	– 0.5
Euro area (FTSE Ebloc 100)*	862.7	888.3	815.4	– 0.2	–44.4	+ 3.7	– 1.9
World (MSCI)†	1,056.3	1,085.8	1,025.9	– 1.9	–27.1	+ 1.9	+ 1.9
World bond market (Citigroup)‡	590.7	619.5	590.7	– 1.7	– 4.7	– 2.1	– 2.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Apr 15th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2004	Current account The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Apr 14th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Apr 14th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 15.9 Feb	− 30.0 Q4	− 5.2	− 4.6	87.2	78.0	1.37	1.65	2.44	1.63	1.26	0.5
Austria	− 1.1 Jan	− 1.5 Jan	− 0.3	− 0.5	103.4§	101.9	0.84	0.93	1.50	–	0.77	-1.2
Belgium	+ 19.3 Jan	+ 8.0 Dec	+ 4.2	+ 4.1	103.6§	101.8	0.84	0.93	1.50	–	0.77	nil
Britain	− 82.4 Feb	− 30.8 Q4	− 2.5	− 2.6	104.8	100.1	0.56	0.64	–	0.67	0.52	-2.9
Canada	+ 44.4 Feb	+ 18.5 Q4	+ 1.6	+ 1.1	85.8	81.1	1.35	1.45	2.41	1.61	1.24	0.7
Denmark	+ 9.6 Jan	+ 6.5 Jan	+ 2.7	+ 2.7	105.9	105.4	6.24	6.88	11.2	7.44	5.76	1.0
France	+ 2.9 Feb	+ 16.7 Jan	+ 1.2	+ 1.0	107.3§	104.9	0.84	0.93	1.50	–	0.77	-3.7
Germany	+156.7 Feb	+ 55.8 Feb	+ 2.4	+ 2.3	105.1§	102.2	0.84	0.93	1.50	–	0.77	-3.7
Italy	+ 1.2 Jan	− 21.6 Jan	− 1.0	− 1.0	76.5§	74.8	0.84	0.93	1.50	–	0.77	-2.9
Japan	+115.3 Feb	+149.9 Feb	+ 3.2	+ 3.2	137.1	129.8	108	120	194	129	–	-6.8
Netherlands	+ 31.9 Jan	+ 14.4 Q4	+ 2.8	+ 3.0	103.2§	101.1	0.84	0.93	1.50	–	0.77	-2.5
Spain	− 53.5 Jan	− 25.0 Dec	− 2.8	− 2.7	77.5§	76.2	0.84	0.93	1.50	–	0.77	0.2
Sweden	+ 20.1 Feb	+ 18.9 Q4	+ 5.6	+ 5.3	80.3	79.6	7.71	8.49	13.8	9.19	7.11	0.5
Switzerland	+ 7.3 Feb	+ 29.4 Q3	+10.3	+10.1	111.4	114.1	1.30	1.39	2.32	1.55	1.20	na
United States	−556.5 Feb	−540.9 Q4	− 5.1	− 5.0	97.9	107.8	–	–	1.79	1.19	0.92	-5.1
Euro area	+ 87.1 Jan	+ 32.4 Jan	+ 0.5	+ 0.4	89.3	87.4	0.84	0.93	1.50	–	0.77	-2.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.4 Jan	+ 9.6 Jan	na	na	82.7§	80.7	0.83	0.93	1.48	–	0.77	1.9
Greece	− 25.9 Jan	− 11.0 Jan	na	na	59.9§	58.9	0.83	0.93	1.48	–	0.77	-1.6
Iceland	− 0.3 Feb	− 0.6 Q4	na	na	93.1**	94.2	73.5	76.2	131	87.6	67.8	0.2
Ireland	+ 39.8 Jan	− 3.0 Q4	na	na	95.2§	92.4	0.83	0.93	1.48	–	0.77	-1.3
Luxembourg	− 3.5 Jan	+ 2.5 Q4	na	na	103.6§	101.8	0.83	0.93	1.48	–	0.77	-1.8
New Zealand	− 2.1 Feb	− 3.5 Q4	na	na	100.6	97.6	1.58	1.79	2.82	1.88	1.46	2.2
Norway	+ 27.8 Feb	+ 30.1 Jan	na	na	96.7	101.6	6.94	7.23	12.4	8.27	6.40	9.7
Portugal	− 13.9 Jan	− 8.0 Jan	na	na	94.7**	91.7	0.83	0.93	1.48	–	0.77	-3.0

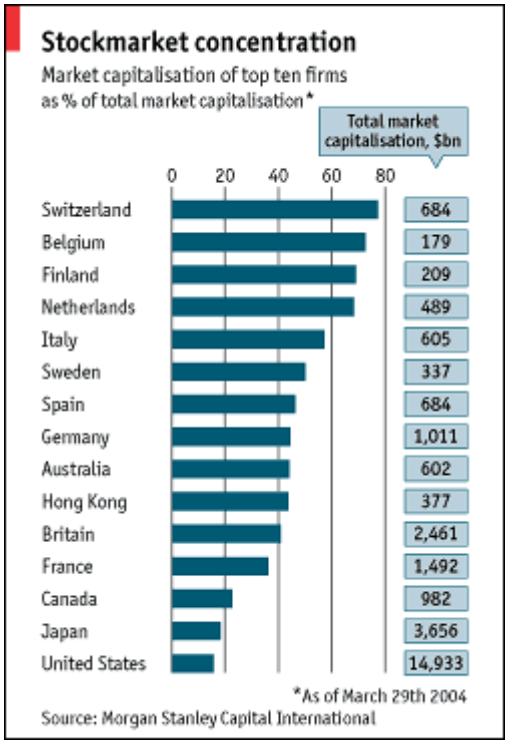
*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD forecast.
**IMF, December average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

About sponsorship

Stockmarket concentration

Apr 15th 2004
From The Economist print edition



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Apr 15th 2004
From The Economist print edition

Singapore's economic growth is accelerating. Its GDP rose by 7.3% in the year to the first quarter of 2004, compared with 4.9% in the year to the fourth quarter of 2003.

Industrial production in **Brazil** rose by 1.8% in the year to February. Consumer prices rose by 5.9% in the year to March, down from growth of 6.7% in the year to February.

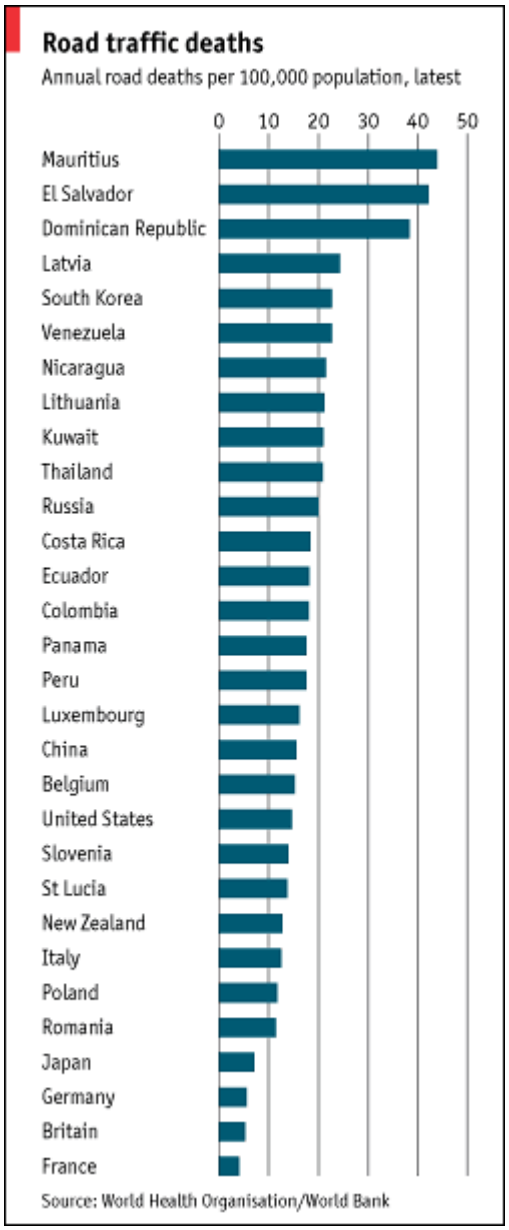
Industrial production in **Turkey** rose by 15.6% in the year to February, up from 7.3% in the year to January.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Road traffic deaths

Apr 15th 2004
From The Economist print edition

Every year over a million people die in road accidents and as many as 50m are injured. Over four-fifths of the deaths are in developing countries. This dismal toll is likely to get much worse as road traffic increases in the developing world. A joint report from the World Health Organisation and the World Bank says that developing countries should adopt the preventive measures that have worked in advanced countries.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Apr 15th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.7	Q1	+23.2	Feb	+ 3.0	Mar	+18.0	Mar	+35.4	2002	439.8	Mar
Hong Kong	+ 5.0	Q4	– 6.1	Q4	– 2.0	Feb	– 9.8	Feb	+17.4	Q4	123.5	Feb
India	+10.4	Q4	+ 7.4	Feb	+ 4.1	Feb	–16.4	Feb	+ 3.2	Q4	106.1	Mar
Indonesia	+ 4.3	Q4	+ 5.1	Jan	+ 5.1	Mar	+28.7	Feb	+ 7.8	Q3	34.8	Feb
Malaysia	+ 6.4	Q4	+16.7	Jan	+ 1.0	Mar	+21.1	Feb	+12.3	Q4	48.3	Feb
Philippines	+ 4.5	Q4	– 0.2	Jan	+ 3.8	Mar	– 1.9	Jan	+ 3.3	Dec	13.0	Mar
Singapore	+ 7.3	Q1	+38.3	Feb	+ 1.6	Feb	+15.8	Feb	+28.2	Q4	101.2	Feb
South Korea	+ 3.9	Q4	+16.6	Feb	+ 3.1	Mar	+24.0	Mar	+18.4	Feb	162.9	Feb
Taiwan	+ 5.2	Q4	+28.0	Feb	+ 0.9	Mar	+16.3	Feb	+28.6	Q4	226.5	Mar
Thailand	+ 7.8	Q4	+16.4	Feb	+ 2.3	Mar	+ 4.0	Feb	+ 7.9	Feb	41.9	Feb
Argentina	+11.3	Q4	+ 9.7	Feb	+ 2.3	Mar	+14.5	Feb	+ 7.9	Q4	14.9	Mar
Brazil	– 0.1	Q4	+ 1.8	Feb	+ 5.9	Mar	+27.2	Mar	+ 5.0	Feb	52.5	Feb
Chile	+ 3.3	Q4	+ 8.0	Feb	– 0.7	Mar	+ 4.2	Mar	– 0.6	Q4	16.1	Feb
Colombia	+ 4.3	Q4	+ 3.6	Dec	+ 6.2	Mar	+ 0.4	Jan	– 1.4	Q4	11.1	Jan
Mexico	+ 2.0	Q4	+ 2.2	Feb	+ 4.2	Mar	– 6.1	Feb	– 9.2	Q4	63.1	Feb
Peru	+ 3.0	Jan	+ 2.9	Jan	+ 2.8	Mar	+ 0.9	Jan	– 1.1	Q4	9.8	Feb
Venezuela	+ 9.0	Q4	+100.4	Jan	+23.6	Mar	+15.0	Q4	+ 9.6	Q4	17.2	Feb
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4	+ 3.9	Q4	13.7	Jan
Israel	– 0.6	Q4	+ 3.0	Jan	– 2.5	Feb	– 6.5	Feb	– 0.2	Q4	26.2	Feb
South Africa	+ 1.5	Q4	– 1.4	Dec	+ 0.7	Feb	+ 1.9	Feb	– 1.5	Q4	8.3	Mar
Turkey	+ 6.1	Q4	+15.6	Feb	+11.8	Mar	–22.5	Jan	– 6.7	Dec	33.3	Feb
Czech Republic	+ 3.1	Q4	+ 3.8	Jan	+ 2.3	Feb	– 2.3	Feb	– 5.7	Q4	27.0	Mar
Hungary	+ 3.6	Q4	+ 9.9	Jan	+ 6.7	Mar	– 3.7	Feb	– 6.0	Feb	12.3	Mar
Poland	+ 4.7	Q4	+18.4	Feb	+ 1.7	Mar	– 7.9	Jan	– 3.7	Feb	36.3	Feb
Russia	+ 5.7	Q3	+ 6.6	Mar	+10.3	Mar	+60.7	Jan	+35.3	Q1	82.6	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.7	Q4	+ 7.9	Feb	+ 0.4	Mar	– 2.0	Feb	– 1.2	Q4	1.3	Feb
Latvia	+ 7.4	Q4	+ 8.5	Feb	+ 4.8	Mar	– 2.1	Feb	– 1.0	Feb	1.4	Feb
Lithuania	+10.6	Q4	na		– 1.0	Mar	– 2.8	Feb	– 1.2	Q4	3.2	Feb
Slovakia	+ 4.7	Q4	+ 7.8	Feb	+ 8.2	Mar	– 0.5	Feb	– 0.3	Dec	12.3	Feb
Slovenia	+ 2.5	Q4	– 0.2	Feb	+ 3.5	Mar	– 0.8	Feb‡	nil	Feb	8.6	Jan
Pakistan	+ 5.1	2003†	–13.3	Dec	+ 5.3	Mar	– 1.6	Mar	+ 3.6	Q4	11.4	Feb
Saudi Arabia	+ 1.0	2002	na		+ 0.4	Feb	+42.6	2002	+11.9	2002	23.9	Jan

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Apr 15th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Apr 14th		Dec 31st 2003	
	Apr 14th	year ago	Apr 14th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.8	2.30	1,779.5	– 4.5	+ 13.4	+ 13.4
Hong Kong	7.80	7.80	13.9	0.14	12,669.9	– 1.7	+ 0.7	+ 0.3
India	43.8	47.4	78.2	4.37	5,904.5	+ 1.4	+ 1.1	+ 5.4
Indonesia	8,604	8,878	15,369	7.57	778.0	+ 0.8	+ 12.4	+ 10.1
Malaysia	3.80	3.80	6.79	3.00	866.3	– 2.0	+ 9.1	+ 9.1
Philippines	55.9	52.8	99.8	8.75	1,483.4	– 2.2	+ 2.8	+ 2.2
Singapore	1.68	1.78	3.01	0.69	1,869.7	– 0.6	+ 6.0	+ 7.0
South Korea	1,158	1,253	2,068	3.91	916.3	+ 1.1	+ 13.0	+ 16.3
Taiwan	32.8	34.8	58.6	1.10	6,880.2	+ 3.7	+ 16.8	+ 20.9
Thailand	39.4	43.1	70.5	1.30	701.7	– 1.2	– 9.1	– 8.7
Argentina	2.82	2.93	5.03	2.88	1,192.2	+ 0.1	+ 11.2	+ 15.8
Brazil	2.90	3.17	5.17	16.08	22,311.0	– 3.3	+ 0.3	nil
Chile	604	720	1,078	1.80	7,485.9	– 1.7	+ 2.0	+ 0.2
Colombia	2,623	2,939	4,686	7.69	3,425.6	+ 0.8	+ 46.8	+ 55.6
Mexico	11.3	10.7	20.1	5.98	10,609.9	– 1.0	+ 20.6	+ 20.3
Peru	3.47	3.47	6.19	2.44	2,993.6	– 0.6	+ 22.9	+ 22.9
Venezuela	3,180§	1,598	5,681	16.56	26,196.1	– 4.8	+ 18.0	+ 5.8
Egypt	6.21	5.76	11.09	8.49	15,199.9	+ 3.7	+ 30.6	+ 29.7
Israel	4.53	4.64	8.10	1.15	573.7	– 1.0	+ 7.4	+ 4.1
South Africa	6.64	8.03	11.9	8.20	10,979.6	+ 0.7	+ 5.7	+ 6.3
Turkey	1,364,500	1,644,500	2,437,543	20.00	18,678.2	– 7.9	+ 0.3	+ 3.3
Czech Republic	27.1	29.5	48.3	2.05	835.1	– 0.8	+ 26.7	+ 20.3
Hungary	211	229	377	11.63	11,405.8	+ 0.7	+ 21.6	+ 19.4
Poland	4.00	4.05	7.14	5.68	25,013.5	+ 1.9	+ 20.1	+ 12.5
Russia	28.6	31.3	51.1	14.00	739.3‡	– 1.4	+ 27.6	+ 30.3
EMF (MSCI)*	1.00	1.00	1.79	na	487.4	– 1.2	+ 10.1	+ 10.1
EMBI+†	1.00	1.00	1.79	na	298.0	– 1.3	+ 1.1	+ 1.1

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.